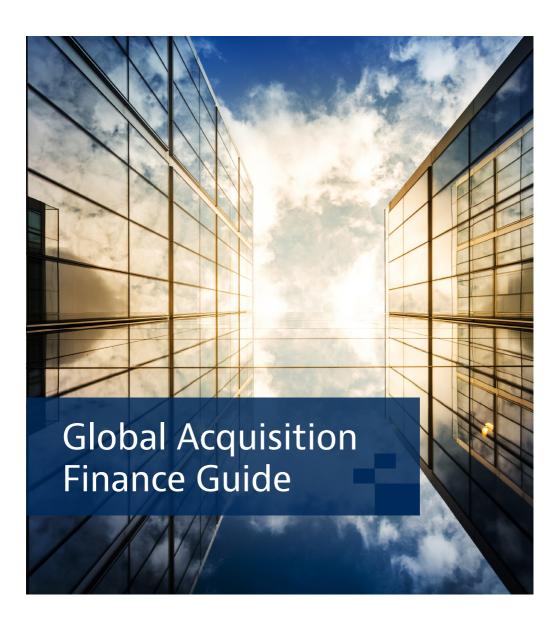
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Global Acquisition Finance Guide

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Introduction

Volatility in today's global financial markets is the new normal. Despite the global unpredictability, there have been strong levels of resilience in the past few years. Looking forward, both emerging and developed markets are proving to be robust economies, attractive for both inbound and outbound investment

Our new 2015 Global Acquisition Finance Guide is a comprehensive guide for market participants and we hope to provide investors with a summary of regulations applicable to acquisition finance transactions around the world

Spanning 36 jurisdictions, the guide brings together the collective knowledge and experience of more than 670 banking and finance lawyers in Baker McKenzie's global network. It looks at the everchanging needs of our clients in this advanced and fast-paced world.

Contact details for each country can be found at the end of the relevant chapter.

We hope you find the Global Acquisition Finance Guide useful.

Gavin Raftery Global Acquisition Finance Chair Baker McKenzie



Argentina

1. Is there any prohibition on a company incorporated in Argentina providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Target company may acquire shares on certain terms and conditions

There is no express prohibition on a company incorporated in Argentina providing financial assistance in connection with the acquisition of shares in itself or its parent company. Under Argentine law, however, a target company may only acquire its own shares:

- (a) to cancel them, if there has been a prior decision to reduce the company's capital;
- (b) exceptionally, with liquidated profits or free reserves if the shares are entirely paid-up, and to avoid serious damage, which must be justified at the next shareholders' meeting; or
- (c) if those shares are part of a bulk transfer (fondo de comercio) acquisition by a third party company and/or part of a company that is merged into the acquiring company.

Court challenges

Notwithstanding the fact that buyouts involving the giving of financial assistance have occurred in Argentina, some of these have been challenged in court, with allegations of fraud by the creditors of the target company. The challenges to this type of transaction arise on the insolvency of the acquired company. The allegations are based on the ground that buyouts involving financial assistance transfer the financing of the transaction to the company, exposing its assets (which are usually encumbered in favor of the creditors that have financed the buyout) and prejudicing the company's other creditors and third parties.

In certain transactions involving financial assistance, courts have ruled that those buyouts violate the following provisions of the Argentine Commercial Companies Law (ACC):

- (a) the administrator's duties of loyalty and care;
- (b) the restriction on companies giving financial assistance in connection with the acquisition of their own shares;
- (c) the use of the corporate structure for non-corporate purposes;
- (d) the administrator's improper use of his/her position or company information for his/her self-gain (personal benefit); and
- (e) the administrator's duty of refraining from participating in a discussion in relation to a particular matter, if there is a conflict of interest with the company.

Administrator refers to directors of corporations (*sociedades anónimas*) and managers of limited liability companies (*sociedades de responsabilidad limitada*).

Duties of directors and managers

As long as managers or directors remain employed by the target company, they must maintain their duties of loyalty and care to the company. Argentine law adopts the "good businessman" standard, which imposes obligations on managers and directors, including to act in good faith and to abstain from improperly using their position or company information for their self-gain (personal benefit). Administrators who find themselves with a conflict of interest with the company must inform other members of the board of directors, and refrain from participating in any discussion in relation to the subject of the conflict.

Moreover, administrators have joint and several liabilities for damages suffered by the company, its shareholders or third parties as a result of their disloyal and unfaithful performance (violation of the "good



businessman" standard), negligence and willful misconduct. However, they may be exempted from any liability if they had no knowledge of the act or omission, or voted against it, disclosing and leaving the matter on record for other administrators, and did not carry out the relevant act. Any attempt to limit or exempt administrators from liability in the bylaws is null and void. As the main function of the board of directors is to provide governance structure protection to the shareholders, administrators will need to analyze those situations in which there may be a conflict of interest, declare themselves disabled when necessary, and refrain from taking a position that is adverse to the company's best interests.

Holding one share allows a shareholder to file individual claims against the directors or statutory auditors (sindicos) for non-fulfillment of their corporate duties. An equity holding amounting to at least 5% of the corporate capital enables the holder to oppose the approval of the performance of the directors and statutory auditors as a condition to initiate corporate liability action (acción social de responsabilidad) against them.

2. What are the implications under the corporate benefit laws of Argentina for a company providing financial assistance?

As stated in the answer to question 1, the challenges to transactions that involve the giving of financial assistance arise on the insolvency of the acquired company. In certain cases, courts have alleged that buyouts, in which financial assistance had been used, violate certain provisions of the ACC. Therefore, a transaction involving the giving of financial assistance may be declared null by the courts.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most typical security interests to be granted are mortgages, pledges and guarantee trusts. Security interests *in rem* are those security interests granted by the principal obligor (or a third party) that create an *in rem* right in favor of the creditor by which the creditor is entitled to proceed against the asset over which the security interest was created, enforce the claim and be satisfied to the extent of the claim with priority over other creditors. In contrast to a personal security interest (e.g., bail), under a security interest *in rem*, a particular asset or assets is/are "set aside" as security. It is also an accessory to a principal obligation and cannot exist without the principal debt, which is secured.

Mortgage

General

A mortgage consists of a security interest *in rem* by virtue of which the debtor or a third party commits certain real estate in order to secure compliance of an obligation, whether present or future, simple or subject to condition. Mortgages are governed by civil law (Sections 3108 to 3203 of the Argentine Civil Code), even though the underlying obligation may be of a commercial nature and the parties to the transaction may be commercial organizations. The following assets may be mortgaged:

- (a) real or immovable property;
- (b) mines, independently of the soil where they are located;
- (c) ships; and
- (d) aircrafts.



If the principal obligation is not paid when due, the mortgagee may foreclose under the mortgage. The foreclosure proceedings are governed by the Argentine Civil and Commercial Code of Procedures. The mortgagee may cause the sale of the property, as determined by a judicial order, and be reimbursed out of the sale proceeds. Because of the mortgagee's security interest over the asset, the mortgagee enjoys priority over the claims of any other creditor, with a few exceptions.

Bankruptcy law governs the order of priority of payment of debts in a bankruptcy. In relation to a mortgage, the creditor will have a firstranking priority over the proceeds of the assets subject to the mortgage, after the setting aside of a sum from the proceeds the asset's sale, to cover:

- (a) the cost of conservation, administration, custody and sale of the relevant asset until the enforcement of the mortgage over the asset, including any applicable taxes due on the security itself; and
- (b) the fees and expenses of the officers of the bankruptcy proceedings in relation to the relevant asset.

Formalities

Mortgages require a civil-law notary to grant a public deed describing in detail the parties, their capacity, the nature and degree of the mortgage, a description of the real estate mortgaged, title to the real estate and the amount of money owed.

The mortgage will also have to be filed with the Real Property Registry of the domicile corresponding to the location of the mortgaged real estate. Mortgage registration is vital to have valid title against, and be acknowledged by, third parties (i.e., to be enforceable vis-à-vis third parties).

Pledge

General

A pledge consists of a security interest *in rem* by virtue of which the debtor or a third party commits a movable asset to secure compliance with a civil or commercial obligation, whether present or future, and with or without a condition.

There are two different types of pledges under Argentine law:

- (a) a regular pledge (which is not subject to registration); and
- (b) a registered pledge.

Regular pledge

With a "regular" or "unregistered" pledge, the creditor (or a third party agreed on by the creditor and debtor) must keep possession of the pledged goods. This pledge may be "civil" or "commercial," depending on the nature of the obligation it secures.

A commercial pledge may affect personal property, merchandise, stock, credits, and, in general, any kind of commercial papers. The commercial pledge can be documented by a public deed or a private agreement executed between the debtor and the creditor. Private documents are not generally subject to specific formalities. A pledge agreement becomes binding on the parties on execution, and *vis-à-vis* third parties on the transfer of possession of the pledged goods.

A commercial pledge grants the creditor preferences over the price of the pledged goods in relation to other creditors of the debtor. If the debtor fails to fulfill its secured obligations (plus pay interest and costs), the creditor has the right to sell the pledged goods at an auction.



Registered pledge

Under a registered pledge, possession of the secured assets remains with the debtor. The parties may also deposit the pledged assets with a third party (who must be specified in the pledge agreement and in the registration form of the pledge with the corresponding pledge registry).

Registered pledges may be established over personal property, livestock or inventories of raw materials or finished products, to secure the payment of any kind of obligation. They can be granted over any kind of assets located in Argentina that can be registered.

Within this category, there are two different types of registered pledges:

- (a) fixed; and
- (b) floating.

A floating pledge may be granted over merchandise and raw materials in general, belonging to commercial or industrial businesses. It is usually used for bulk commodities.

Registration/formalities

Fixed pledges must be registered with the public pledge registry of the jurisdiction where the secured assets are located (**Pledge Registry**). Floating pledges must be registered with the Pledge Registry of the domicile of the debtor

Registered pledges must be executed in a standard form that the Pledge Registry provides, and must be subsequently registered with the relevant Pledge Registry. The parties to the pledge contract are free to include additional terms and conditions or a full pledge agreement as an annexure to the form provided by the Pledge Registry. The annexure operates as a pledge agreement. The pledge

agreement becomes binding on the parties on execution, and *vis-à-vis* third parties on registration with the Pledge Registry.

Enforcement of a pledge

Pledged assets that are registered with a Pledge Registry grant the creditor the right to start summary collection proceedings. Basically, creditors who have been granted a pledge as security have the right to request the seizure of the pledged assets and then sell those pledged assets through a court auction. The proceeds will be applied, firstly, to pay all taxes and expenses incurred to protect the assets and secondly to pay the principal and interest on the debt secured by the pledge.

Pledged goods registered with the Pledge Registry grant the creditor preferences in relation to other creditors of the debtor. In the event of a reorganization or bankruptcy, creditors have to register their credits with the bankruptcy trustee. However, debts secured by registered pledge have special privilege over the proceeds of the assets of the debtor. A creditor who has a debt secured by a security interest of registered pledge may at any time claim payment by bringing a petition in the bankruptcy proceedings for the sale of the asset in relation to which the creditor has been granted a pledge.

Guarantee trust

In Argentina, trusts are governed by Law No. 24,441 (**Trust Law**). One of the available trusts under the Trust Law is the guarantee trust, by means of which the debtor of an obligation or another person on its behalf, acting as grantor, transfers a movable or immovable asset on trust to another person (acting as trustee) as security for the payment of an obligation to a third party (the beneficiary of the trust).

The role of the trustee is to follow up compliance with the payment and other obligations assumed by the debtor and, if there is non-compliance with those obligations, to carry out certain acts required to enforce the assets set aside as security to pay the beneficiary.



Stamp tax

From a tax standpoint, the issuance and implementation of security interests such as mortgages, pledges, and guarantee trusts, among others, may trigger the application of stamp tax on the security document/agreement.

Stamp tax is a local tax on documents usually applied at the rate of 1%, depending on each local jurisdiction, on any document or exchange of documents evidencing the creation, amendment or extinction of pecuniary rights or obligations.

In some local jurisdictions, documents implementing the security interest may be exempted from stamp tax if the corresponding stamp tax was paid in relation to the agreement containing the principal obligation secured by the security interest paid.

Finally, there are certain mechanisms to legally avoid the creation of a taxable document for stamp tax purposes.

4. How long, following the acquisition of a foreign target company, would it usually take in Argentina for an Argentinian subsidiary of that foreign target company to grant a guarantee/security?

A local subsidiary duly registered in Argentina would be able to grant a guarantee/security immediately. Timing will depend on the complexity of the financing and security structure, and may also vary for different types of guarantee/security, due to the formalities required for each type.

5. Are there any restrictions on foreign banks lending to companies in Argentina? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

There are restrictions on foreign banks lending to companies in Argentina.

Financial activities in Argentina are governed by the Financial Entities Law No. 21,526 (FEL) and supervised by the Argentine Central Bank (ACB). The FEL regulates all persons or entities, whether private or public, which intermediate on a continuing basis between the supply and demand of financial resources in Argentina. Therefore, only authorized financial entities may lend to companies in Argentina.

There is total freedom of entry and exit of financial institutions to and from the market, as well as for their merger or absorption. From a corporate perspective, under Argentine law, the general principle is that a local presence is required when a foreign entity is performing activities in Argentina on a regular basis, in contrast with isolated activities. If the foreign entity is conducting activities on a regular basis (e.g., disbursement of several loans), a local corporate presence is needed.

There is no express prohibition on a foreign financial entity performing an isolated act only (e.g., one particular loan). Nevertheless, if the borrower fails to perform its obligation, the foreign entity may have difficulty enforcing the debt due to lack of legal standing, on the basis that there is no local corporate presence. This is because granting the loan and enforcement of the loan may be considered to be two acts and therefore not merely one isolated act. These restrictions would apply in case of foreclosure of local security interests, but not necessarily in the case of foreclosure of security interests located offshore and based on transactions governed by foreign legislation and subject to foreign jurisdiction.



It is important to note that currency exchange controls have been implemented in Argentina by applicable legislation and further regulated by the ACB. For the purposes of avoiding the influence of volatile capital in the market, and creating the necessary mechanisms to track and maintain control over the remittance of funds in and out of Argentina, on 10 June 2005, the executive branch issued Executive Order 616/2005 imposing the obligation to carry out settlements of foreign exchange in the local foreign exchange market and requiring the repatriation of capital repayments and investments for at least a 365-day term (with the term commencing on the date the capital repayments and investments are repatriated into Argentina).

Also, foreign finance is subject to a mandatory requirement that 30% of the funds to be disbursed must be set aside in a non-interest bearing fixed-term deposit with the local financial entity in charge of converting the incoming funds into pesos. The ACB has issued certain exceptions to the mandatory deposit. For example, a loan granted for the acquisition of non-financial assets (bienes de uso) is exempt from this mandatory requirement, if the loan has an average maturity of at least two years.

Tax

Interest on loans granted by a foreign bank to an Argentine entity will be subject to income tax withholding in Argentina at an effective rate of 15.05% if:

- (a) the borrower is an Argentine legal entity or individual; and
- (b) the lender is a banking or a financial entity subject to supervision by a specific banking supervising authority and either:
 - (i) not incorporated in a low-tax jurisdiction or;
 - (ii) if it is incorporated in a low-tax jurisdiction, incorporated in a country which executed a treaty to exchange information with the Argentine Republic.

Also the foreign bank that granted the loan cannot refuse to provide information, on the grounds of bank and exchange secrecy obligations, when requested by the Argentine tax authority.

If however the borrower is an Argentine corporation (excluding banking financial entities) or an individual, and the lender refuses to provide the information, interest on loans granted by the foreign bank to the Argentine entity will be subject to income tax withholding in Argentina at an the full income tax rate of 35%.

The above income tax withholding rates established under the Argentine domestic legislation may be reduced if a tax treaty entered into by Argentina is applicable and certain requirements are met.

Also, interest will be subject to VAT at a rate of 21% at the earlier of:

- (a) the date established for the payment of the interest; or
- (b) the date that the interest is paid, either in whole or in part.

The VAT rate is reduced to 10.5% if the foreign loan is granted by a financial entity incorporated in a country that has adopted the Basel Banking Standards.

The VAT applicable on interest must be reported and paid to the Argentine Federal Tax Authorities by the local entity (i.e., the borrower). This VAT, however, will be recoverable through input credits

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Argentina what requirements regulate the certainty of the availability of that bank debt when the deal closes?

The Argentine Securities Exchange Commission (*Comisión Nacional de Valores*) (**ASC**) regulates markets dealing with the public offering of securities in Argentina. Individuals and entities dealing in public securities markets and public offering of all securities (other than the



primary issues of government securities) are subject to the ASC's control

Section 33 of Chapter II (Public Offering Acquisition) of the ASC's Regulations 2013 (Normas N.T.2013) provides that the offeror of a public offering acquisition must certify before the ASC the establishment of guarantees for the fulfillment of the offer. When cash is used as consideration, the guarantee must be:

- (a) cash or public securities; or
- (b) a guarantee issued by a financial entity of Argentina.

When securities are used as consideration, the offeror must show:

- (a) the availability of those securities; and
- (b) that the securities are going to be used as consideration in relation to the offer
- 7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Insolvency regime

The Argentine Commercial Code contains the Bankruptcy Law, which sets out three insolvency proceedings applicable to private companies:

- (a) reorganization (concurso preventivo);
- (b) pre-packaged reorganization plan (acuerdo preventivo extrajudicial); and
- (c) bankruptcy (quiebra).

Banks and other financial institutions are not subject to reorganization but rather to Central Bank intervention (*Planes de Reorganización y Saneamiento*) or bankruptcy.

According to Argentine law, there are two basic kinds of creditors:

- (a) secured; and
- (b) unsecured.

The secured creditors have different preferences. There are those with special preference and others with general preference. However, these preferences may be waived by any creditor in favor of other creditors.

Secured creditors

Special preferences

Creditors accepted by the court with a special preference are entitled to collect their claims from the proceeds of the auction of any asset over which the creditor had a special preference, according to the following order of preference:

- (a) creditors for expenses originated in the conservation, administration and liquidation of assets (e.g., legal fees of the trustee and its attorneys, payment of taxes over the debtor company's assets, etc.). A creditor may make a request to the court for payment of these expenses at any time from the date on which the expenses are due;
- (b) creditors who have a right to withhold certain assets of the debtor company (as long as no other creditor had a previous right in relation to that asset);
- (c) creditors for expenses in relation to the construction and development of some of the debtor company's assets;
- (d) labor creditors for salaries due by the debtor company to the employees for the previous six months and for severance or labor



- accidents (this preference only applies in relation to the debtor company's assets located in the site where the employee performed his or her activities):
- (e) creditors for taxes and contributions in relation to certain assets:
- (f) creditors secured by a mortgage, pledge or guarantee trust over certain assets: and
- (g) creditors with bonds secured by a special or floating security interest

General preferences

The following creditors are entitled to collect their claims from the proceeds of the debtor company's asset liquidation after all creditors with special preference have been paid out. The creditors are:

- (a) labor creditors for salaries due by the debtor company to the employees for the previous six months, and any other amount due by the debtor company as a result of a labor relationship including in relation to severance, labor accidents and vacations (this preference only applies when the creditor was not able to collect from the proceeds of the liquidation of the debtor company's assets located at the site where the employee performed his/her activities);
- (b) social security and unemployment fund organizations;
- (c) tax authorities; and
- (d) claims backed with expressly accepted invoices (facturas de *crédito*) up to the amount of ARS20,000 (approximately USD2,160 at the August 2015 official exchange rate).

Unsecured creditors

Once all creditors with special preference and with general preference have been paid, those creditors who did not have any preferences are entitled to collect their claims on a *pro rata* basis.

General

On the liquidation of the debtor company's assets, the proceeds of the liquidation must be distributed on the basis of the order of priorities set out above. Payment to all creditors in each category must be fully satisfied before the proceeds of the liquidation may be used for the payment of creditors in a subsequent category. However, creditors having priority over specific collateral and who are not fully satisfied from the proceeds of that specific collateral participate in the distribution of the proceeds of the other assets of the debtor company (in relation to the remainder of their claims) as unsecured creditors.

Within the same category of creditors, the proceeds of the liquidation, if insufficient to fully satisfy the creditors in that category, will be distributed *pro rata* among the creditors in that category in proportion to the amount of their claims.

8. Is interest on debt incurred to acquire a company in Argentina deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Argentine tax authorities have challenged the deduction of interest and foreign exchange losses in relation to loans granted to acquire Argentine entities on the ground that those expenses were not related to obtaining, keeping and/or maintaining income subject to income tax. The reasoning for this was that the income arising from the shares/quotas of an Argentine entity (i.e., dividends/gains distributed by those entities) were, as a general rule, not subject to income tax.

The interpretation made by the Argentine tax authorities on this issue is debatable and is currently under discussion in the courts. There are some precedents in favor of the deduction of the interest but the final



decision from the Federal Supreme Court is still pending. Notwithstanding the above, as a result of a recent amendment to the Argentine Income Tax Law, dividends/gains to be distributed by an Argentine entity are now subject to income tax at a rate of 10%. The grounds issued by the Argentine tax authorities to reject the deduction of interest and foreign exchange losses arising from loans to acquire an Argentine entity are no longer applicable.

Therefore, in our opinion, interest (and foreign exchange losses) is now deductible from the income tax basis subject to the restrictions described below

In effect, Argentine Income Tax Law establishes thin capitalization rules that limit the deduction of certain categories of financial interest paid by companies other than banks and financial institutions. In effect, according to Section 81 of the Argentine Income Tax Law, the following categories of financial interest are fully deductible:

- (a) financial interest paid to resident estates and individuals; and
- (b) financial interest paid to a foreign party, other than banks and financial institutions, as long as that interest payment is subject to a 35% withholding tax.

Therefore, thin capitalization rules do not apply to disallow the deduction of interest accrued on inter-company financings that has been subject to a 35% income tax withholding. If the taxpayer fails the test, then the portion of interest accrued on the excess of the taxpayer's indebtedness giving rise to financial interest, other than loan-generating financial interest in categories (a) and (b) above. which exceeds two times the taxpayer's net worth will be treated as a dividend and will not be deductible for income tax purposes.

Also, foreign exchange losses are fully deductible in the local accounts on a market-to-market basis to the extent the loan has arm's length terms.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Argentina?

Contractual subordination will be honored by a liquidator or bankruptcy trustee in Argentina. Section 250 of the Bankruptcy Law expressly provides that a debt that has been contractually subordinated by the parties will be governed by the contractual terms agreed by those parties.

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Australia

1. Is there any prohibition on a company incorporated in Australia providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Financial assistance permitted under regulated conditions

In Australia, a company can provide financial assistance in certain prescribed circumstances.

Part 2J.3 of the *Corporations Act 2001* (Cth) (Corporations Act) regulates the provision of financial assistance by a company for acquiring shares in that company or a holding company. While Section 260A of the Corporations Act permits the giving of financial assistance, the Section permits it under regulated conditions only.

Section 260A(1) states that:

"A company may financially assist a person to acquire shares (or units of shares) in the company or a holding company of the company only if.

- (a) giving the assistance does not materially prejudice:
 - (i) the interests of the company or its shareholders; or
 - (ii) the company's ability to pay its creditors; or
- (b) the assistance is approved by shareholders under Section 260B; or
- (c) the assistance is exempted under Section 260C."

The intention of Section 260A(1)(a) is to allow the company to undertake normal commercial transactions which do not prejudice the company's financial position. However, there is no definition of "material prejudice" in the Corporations Act and this is, therefore, a

question of judgment to be assessed on the particular facts and circumstances of each transaction. Particular regard must be paid to the assistance to be given and the financial consequences for the company and its shareholders.

As financial assistance is often complex in nature, it may be difficult to assess with certainty whether there will be any material prejudice.

Therefore, where the assistance does not fall within one of the exemptions under Section 260C (see the limited circumstances below where this applies), it is more usual to obtain shareholder approval under Section 260A(1)(b) than to rely on a determination that no material prejudice will occur.

Shareholder approval

The requirements for obtaining shareholder approval (commonly known as the "Financial Assistance Whitewash Procedure") are set out in Section 260B. Approval must be given by a special resolution passed at a general meeting of the company or by a resolution agreed to, at a general meeting, by all of the ordinary shareholders.¹

However, it is not just the shareholders of the company giving the financial assistance who must approve that assistance:

(a) under Section 260B(2), if the company will be a subsidiary of an Australian listed corporation immediately after the acquisition, then the financial assistance must also be approved by special

¹ There is no need to hold a meeting where: (a) the company is a proprietary company and all of the members agree to proceed by way of a written resolution; or (b) the company is a single-member company and the resolution is passed by way of a written resolution signed by the sole member.



- resolution passed at a general meeting of that Australian listed corporation;² and
- (b) under Section 260B(3) if, immediately after the acquisition, the company will have an Australian holding company that is not listed and is not itself a subsidiary of an Australian corporation, the financial assistance must also be approved by a special resolution passed at a general meeting of that ultimate Australian holding company.

Sections 260B(5) to (7) set out procedures to be followed in obtaining the relevant shareholders' approval. The first step is for the company to hold a directors' meeting to approve the financial assistance documentation, which typically includes the relevant notice to shareholders, the shareholders' resolutions setting out the details of the financial assistance being given and approvals being sought, and the relevant forms that are required to be lodged with the Australian Securities & Investments Commission (ASIC).

Once the company's directors have approved the financial assistance documentation, the relevant notice to shareholders, together with all documentation relating to the financial assistance that will accompany the notice to shareholders when sent to the shareholders, must be sent to the shareholders. At the same time, the company must lodge at ASIC a "Notification of Financial Assistance Details" (ASIC Form 2602), together with the relevant exhibits.

Once the shareholders' meeting has been held (or the appropriate resolutions have been passed by written procedure), a further notice must be lodged at ASIC notifying it of the intention to give financial assistance (ASIC Form 2601). Financial assistance cannot be given until at least 14 days after the lodgment of ASIC Form 2601. This

² An Australian listed corporation cannot approve the financial assistance by way of written resolution signed by all members but must hold a general meeting. This may not always be practical.

means financial assistance typically can be only given after an acquisition is completed.

Exemptions

The exemptions provided in Section 260C are for financial assistance that is given:

- (a) in the ordinary course of commercial dealing and consisting of:
 - (i) acquiring or creating a lien on partly paid shares in the company for amounts payable to the company on the shares;
 or
 - (ii) entering into an agreement with a person under which the person may make payments to the company on shares by installments;
- (b) by a financial institution in the ordinary course of its business on ordinary commercial terms;
- (c) where a company issues debentures to raise money, by the subsidiary providing a guarantee or other security in the ordinary course of commercial dealing for the repayment of the money by the holding company;
- (d) under an employee share scheme approved by a general meeting of the company;
- (e) by a reduction of share capital or a share buy-back in accordance with Part 2J.1 of the Corporations Act;
- (f) under a court order; or
- (g) by a company discharging on ordinary commercial terms a liability incurred on ordinary commercial terms.



Consequences of failure to comply

Failure to comply with Part 2J.3 of the Corporations Act does not affect the validity of the financial assistance or of any contract or transaction connected with it, nor is the company guilty of any offence (as it is considered to be a "victim" (Section 260D(1) of the Corporations Act)).

However, any person who is involved in a company's contravention of Part 2J.3 contravenes Section 260D(2) of the Corporations Act. This is a civil penalty and the remedies available include:

- (a) disqualification from managing corporations (Section 206C);
- (b) a penalty of up to AUD200,000 (Section 1317G); or
- (c) an order to compensate the company (including for any profits made by the person resulting from the contravention) (Section 1317H).

Section 260D(3) of the Corporations Act further provides that, where the involvement of a person is dishonest, then that person commits a criminal offence, which is punishable by a maximum penalty of a fine of 2,000 penalty units (AUD340,000) or imprisonment of up to five years, or both (Section 1311 and Schedule 3).

Under Section 79 of the Corporations Act, that "involvement" includes:

- (a) aiding, abetting, counselling or procuring the contravention;
- (b) inducing (whether by threats or promises or otherwise) the contravention;
- (c) being in any way (directly or indirectly) knowingly concerned in, or party to, the contravention; or
- (d) conspiring with others to effect the contravention.

Clearly this wide definition is capable of extending liability to lenders providing finances for the acquisition and/or the lawyers acting for the parties to the transaction.

2. What are the implications under the corporate benefit laws of Australia for a company providing financial assistance?

In Australia, directors of a company have a duty to act in good faith, for the benefit of the company as a whole and for a proper purpose. This duty arises both under the general law (as a fiduciary duty) and also under Sections 181 and 184 of the Corporations Act.

As this duty also applies to dealings between companies in a corporate group, when considering providing financial assistance for the acquisition of the company's shares, directors must continue to act in good faith for the benefit of that company. Although the benefit may be either direct or indirect, it may still be difficult for a director to determine if the provision of the financial assistance (while in the best interests of the holding company and/or group of companies as a whole) is actually in the best interests of the company.

Therefore, Section 187 of the Corporations Act provides that, where a company is a wholly owned subsidiary, a director will be taken to act in good faith in the best interests of the subsidiary if:

- (a) the constitution of the subsidiary expressly authorizes the director to act in the best interests of the holding company; and
- (b) the director acts in good faith in the best interests of the holding company; and
- (c) the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act.

This section does not apply where the company is only partly owned. Therefore, if the financial assistance was to be given by a company for the acquisition of only some of its shares, then the directors would be



required to act for the benefit of the company as a whole, including the minority shareholders.

When determining whether an act is for the benefit of the company, consideration must also be given to the solvency of the company. It has been held that if the company is insolvent or nearly insolvent, then the term "interests of the company" will include the interests of the creditors

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security, and if so, what is the basis for calculation?

The type of security granted over a company's assets in acquisition finance transactions in Australia and the technical requirements for effecting the security differs according to whether the security is granted over land or personal property (such as shares and other assets).

Security over land

Security over land is granted under real property mortgages. Real property mortgages must be registered with the land registries of the relevant states and territories. Registration requires the real property mortgage to sufficiently identify the debt secured by the mortgage and the land and interest over which the mortgage is granted, and to be duly executed and stamped (if applicable). The states and territories also have their own local formalities that must be followed for registration of real property mortgages, such as prescribed registration forms to be used and lodgment and execution requirements.

Security over personal property

A new regime for security over personal property was recently introduced under the Personal Property Securities Act 2009 (Cth) (PPSA). The PPSA came into effect on 30 January 2012 and

fundamentally changed the way security over personal property is granted, perfected and registered in Australia. The PPSA applies to most forms of tangible and intangible personal property (including licenses, shares, goods, motor vehicles and documents of title) but does not cover land, fixtures, water rights and other excluded personal property such as certain rights and entitlements granted under statute.

The PPSA has introduced a new concept of a "security interest" which not only covers pre-existing forms of security interests in personal property such as fixed charges, floating charges, pledges and liens but also extends to any interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (Section 12). By taking a substance-over-form approach, the PPSA has made the concept of ownership title irrelevant. This new concept of security interest covers a range of transactions that were previously not treated as security in Australia, such as flawed asset arrangements, retention of title arrangements and leases of goods.

Following the implementation of the PPSA, security documents that were previously referred to as fixed and floating charges are now referred to as general security agreements and fixed charges over specific assets (such as share mortgages) are now referred to as specific security agreements. Chargors are now referred to as "grantors" and chargees as "secured parties."

Although the PPSA has not abolished the concept of fixed charges and floating charges, it has rendered the distinction between them irrelevant by replacing the concept of crystallization with the concept of "attachment". Attachment is the process by which a security interest becomes enforceable against the grantor (Section 19(1)). Floating charges have been replaced by the concept of a security interest attached to a "circulating asset"³. Fixed charges have been

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³ Generally, circulating assets include personal property subject to a security interest in respect of which the secured party has given the grantor express or implied authority for any transfer of the personal property to be made, in the ordinary course of the grantor's business, free of the security interest, and,



replaced by the concept of a security interest that has attached to personal property that is not a circulating asset (Section 339).

Attachment occurs if the grantor has rights in the personal property and the grantor either accepts value for granting the security interest (e.g., by way of a loan from the secured party) or does another act by which the security interest arises (Section 19(2)). If a written security agreement describing the secured property is also signed by the grantor, the security interest will become enforceable against third parties (Section 20(1)). However, unless the security interest is "perfected", it will lose priority to a perfected security interest in the same personal property (Section 55(3)) and will vest in the grantor on insolvency (Section 267). Unless the secured party has possession or control⁴ of the personal property, it may only perfect its security interest by an effective registration on the Personal Property Securities Register (**PPS Register**). The PPS Register operates as an electronic notice board

Registration on the PPS Register involves the secured party (or its agent) lodging a simple "financing statement", online. It is not necessary for a copy of the security agreement to be lodged on the PPS Register and, subject to certain conditions, ⁶ a financing statement

subject to certain exceptions, certain other forms of personal property commonly regarded as current assets, including currency and inventory (Section 340).

⁴ Perfection by control is only possible for certain types of personal property (Section 21(2)(c)).

A financing statement is an electronic notice containing, among other things, certain information about the secured party, the grantor, the secured property and the security interest (Section 153).

A person must not lodge a financing statement unless it believes on reasonable grounds that the person described in the financing statement as the secured party is, or will become, a secured party in relation to the personal property (otherwise than by virtue of the registration itself) (Section 151(1)). If the anticipated security interest does not arise because the grantor refuses to grant it, the person that lodged the financing statement in advance must discharge the registration by lodging a "financing change statement" within 5

can even be lodged before the security agreement is entered into. Although there is no statutory obligation to register security interests on the PPS Register, a security interest granted by a company under the PPSA should be registered within 20 business days of the date the relevant security agreement comes into force (unless the security interest is perfected by possession or control) to avoid the security interest vesting in the grantor on its insolvency (Section 588FL Corporations Act).

Stamp duty

Stamp duty is a state and territory government tax, which is levied on many documents, including loan securities. Mortgage duty is being phased out and is now only applicable in New South Wales. The proposed abolition of New South Wales mortgage duty that was previously scheduled for 1 July 2013 has been deferred indefinitely. The rate of duty in New South Wales is 0.4% and is payable on the amount of secured debt (and may also include other secured financial accommodation such as forbearances). The amount of duty payable in New South Wales is usually calculated based on a percentage of the amount secured by the security, but it can also be dependent on the value of the assets located in each particular state or territory. Other forms of stamp duty will also frequently apply to certain dealings in securities and specialist advice on the stamp duty aspects of each particular transaction needs to be obtained.

4. How long, following acquisition of a foreign target company, would it usually take in Australia for an Australian subsidiary of that foreign target company to grant a guarantee/ security?

This depends on the number of Australian target subsidiary companies involved and the group structure, including whether any Australian

business days of learning that the security interest would not be granted (Sections 151(2) and (3)). Civil penalties for breach of these obligations may apply.



parent company (either direct or ultimate) is a public company. Not only must shareholders of the company that is granting financial assistance effect a whitewash, the ultimate Australian holding company must also approve the financial assistance, and where the holding company (either direct or ultimate) is a public company, that holding company must also obtain the consent of its shareholders by means of the "Financial Assistance Whitewash Procedure".

Generally, where there are financial assistance issues, the quickest period in which an Australian subsidiary can provide a guarantee or security is 15 days from the acquisition. This would require a shareholders' meeting to be held on the day of the acquisition (following all of the necessary lodgments at ASIC and notifications to shareholders being issued) and then for the notification of the intention to give financial assistance (ASIC Form 2601) to be lodged at ASIC on that same day. The financial assistance can then be provided after 14 clear days from the day that ASIC Form 2601 is lodged.

Where a public company is involved, that company will often try to avoid having to call an extraordinary general meeting of its shareholders and will prefer to wait until its next annual general meeting (AGM) before approving the financial assistance to be given, either by it directly, or more usually by one of its Australian subsidiaries. It could therefore be up to a full year before the next AGM and, once held, the shareholders' approval has to be lodged at ASIC and a further 14 clear days must elapse before the financial assistance can actually be given. It would be unusual for a lender to agree to wait for the next AGM if it is almost a year away. However, periods of between three and six months for the provision of the security are not uncommon.

5. Are there any restrictions on foreign banks lending to companies in Australia? Are interest payments to foreign banks typically subject to withholding tax?

Restrictions on foreign banks lending in Australia

A foreign bank lending in Australia may be subject to various regulatory regimes and licensing requirements if it is:

- (a) carrying on a banking business in Australia;
- (b) carrying on a financial services business in Australia;
- (c) carrying on business in Australia; or
- (d) a "registrable corporation" under the *Financial Sector (Collection of Data) Act 2001* (Cth) (the **Financial Sector (Collection of Data) Act)**.

Carrying on a banking business

A foreign bank which carries on a "banking business" under the *Banking Act 1959* (Cth) (**Banking Act**) must do so through a locally incorporated subsidiary or branch and must be approved by the Australian Prudential Regulation Authority (**APRA**) to be an authorized deposit-taking institution. It will be regulated by APRA under the Banking Act. A company is deemed to be carrying on a banking business under the Banking Act if it is taking deposits, making advances or conducting other financial activities prescribed by the *Banking Regulations 1966* (Cth). If a foreign bank merely lends to companies in Australia and does not take deposits, it will not require approval by APRA or be regulated by the Banking Act.

Carrying on a financial services business

A company which carries on a "financial services business" in Australia must be licensed to do so by ASIC and will be regulated by ASIC under Chapter 7 of the Corporations Act.



A company is deemed to carry on a financial services business if, among other things, it deals in a financial product as defined in the Corporations Act. Credit facilities are generally excluded from the definition of "financial product" (Section 765A(h) of the Corporations Act) and the provision of a credit facility only to an Australian company will not trigger regulation by ASIC as a financial services business.

Carrying on business in Australia

A foreign company which "carries on business" in Australia must be registered with ASIC under the Corporations Act and comply with various disclosure and other requirements imposed on registered foreign companies under the Corporations Act. There is no specific test for determining if a company is carrying on business in Australia and whether a company is doing so depends on the circumstances in each particular case. Lending to an Australian company on a one-off or very limited basis will, in most cases, probably not qualify as carrying on business in Australia but repeated lending and a course of dealing will most likely constitute carrying on business and require registration.

Registrable companies

A company which is a "registrable corporation" under the Financial Sector (Collection of Data) Act must be registered with APRA as such and, although it will not be subject to supervision by APRA, must comply with certain disclosure and reporting requirements. A foreign company is a "registrable corporation" if it has assets exceeding AUD25 million and, among other things:

- (a) its principal business activity in Australia is the provision of finances; or
- (b) the value of the debts due to it as a result of that activity is equal to 50% or more of its total assets in Australia

Interest payments and withholding tax

Interest withholding tax, at the rate of 10%, is payable on interest paid to a foreign resident bank not carrying on business through an Australian permanent establishment by:

- (a) an Australian resident borrower not operating through an offshore permanent establishment; or
- (b) a non-resident borrower carrying on business through an Australian permanent establishment.

However, a foreign resident bank may be entitled to an exemption from interest withholding tax if interest is paid on certain publicly offered debt instruments and syndicated loan facilities that meet the prescribed requirements in Section 128F of the *Income Tax Assessment Act 1936* (Cth).

In addition, under some Australian double tax treaties (e.g., the agreements with the US, UK, Finland, France, Japan, Norway, South Africa), the interest withholding tax rate may be reduced to nil where the interest is paid to a foreign resident "financial institution" which:

- (a) qualifies for the treaty benefits (e.g., by satisfying the limitation of benefits article, such as that present in the Australia-US treaty); and
- (b) is unrelated to and operating wholly independently with the Australian borrower; and
- (c) does not enter into a back-to-back lending arrangement.

A "financial institution" for these purposes includes enterprises that substantially derive their profits by raising debt finance in their financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance. That is, the exemption is not limited to banks.



6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Australia, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Both the Corporations Act and the Australian Takeovers Panel (Panel) impose certain threshold requirements and disclosure obligations as to certain funds in a takeover bid for an Australian public company.

Corporations Act

The Corporations Act regulates public takeovers of Australian companies and under it, bidders cannot:

- (a) be reckless when announcing a bid as to whether they can perform if a substantial proportion of the offers under the bid are accepted (Section 631(2)])(b));
- (b) in a market bid, impose any conditions on the bid (Section 625(1); or
- (c) in an off-market bid, make a bid that is conditional on events within its control or discretion (Section 629).

The Corporations Act also requires that certain information relating to a bidder's funding be disclosed on the bidder's statement required to be filed with ASIC including, among other things, the identity of any person who is to provide cash consideration from that person's own funds and any arrangements under which that cash consideration is to be provided.

Australian Takeovers Panel

The Panel has broad power to intervene in public takeover bids when it determines "unacceptable circumstances" exist in relation to a takeover. In its Guidance Note 14: Funding Arrangements (**Note 14**), the Panel states that in order to avoid unacceptable circumstances

arising from funding arrangements, a bidder must at all times have (and maintain) a reasonable basis to expect that it will have sufficient funding arrangements in place to satisfy full acceptance of its offers.

The Panel explained that what constitutes a reasonable basis depends on the circumstances of each individual case and also changes throughout the period from the announcement of a bid to the payment of shareholders, with the required degree of certainty increasing as time progresses. Some guidance is provided by Note 14 in the form of examples of situations in which the bidder will most likely not have a reasonable basis to believe it will have sufficient funding. They include, among others, where financing arrangements:

- (a) remain subject to internal credit approval;
- (b) are the subject of an informal or unenforceable arrangement;
- (c) remain subject to documentation (unless there is a binding commitment in place which provides the required reasonable basis);
- (d) are on a "best endeavors" basis; and
- (e) are subject to conditions precedent which the bidder does not have a reasonable basis to believe will be satisfied or waived.

In practice, a commitment letter and credit approved term sheet will usually meet the "reasonable basis" requirement of Note 14 if they are binding and set out all material terms and conditions.

Note 14 also requires that a bidder disclose in its bidder's statement discussed above or other disclosure documents the nature and details of its funding arrangements.



7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Section 555 of the Corporations Act states that, subject to Section 55b, all debts and claims will rank equally and, if the property of the company is insufficient to meet them in full, they will be paid proportionately. Section 556 of the Corporations Act then provides a list of categories of creditors who will be paid ahead of other creditors.

In general, in the winding up of a company, the order of ranking of creditors is:

- (a) creditors with security, such as a real property mortgage or a registered PPSA security interest in the company's non-circulating assets (provided that the security interest was perfected by registration, and no other means, either 6 months before the winding up commenced, within 20 business days of the date the security agreement giving rise to the security interest came into force or by a later date ordered by the Court under Section 588FM of the Corporations Act):
- (b) unsecured creditors given priority by Section 556. Section 556 lists different classes of unsecured creditors with priority over other unsecured creditors. Those classes include, among others:
 - (i) costs and fees of the liquidator and administrator, including:
 - costs and expenses properly incurred by a relevant authority in preserving or realizing or getting property of the company;
 - applicant's costs in obtaining the winding-up order; and
 - remuneration of the relevant authority, his/her partners or staff for services provided, and expenses incurred by the relevant authority for services provided by a third party

that could instead have been reasonably provided by the relevant authority, his/her partners or staff; and

- (ii) employees' wages and superannuation contributions payable by the company in respect of services rendered to the company prior to liquidation (unlimited for ordinary employees); and
- (c) ordinary unsecured creditors.

Under Section 561 of the Corporations Act, a secured creditor's floating charge or security interest attached to circulating assets is subordinate to certain employees' claims.

Within the band of creditors with security, the PPSA determines the priority of payment between competing PPSA security interests attached to the same personal property. The PPSA has significantly changed the priority rules that previously applied to security over personal property under the Corporations Act and general law. Under the PPSA, ownership title and the concept of crystallization are no longer relevant to determining priority. The PPSA contains a range of default priority rules (Section 55) and numerous exceptions to those rules to cover specific circumstances, including where the security interest is a perfected purchase money security interest (**PMSI**)⁷.

In general, the following rules apply in respect of priorities between PPSA security interests:

(a) priority between unperfected security interests in the same secured property is determined by the order of attachment of the security interests (Section 55(2));

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⁷ A PMSI may arise, among other ways, where a security interest is taken in personal property by a secured party that agrees to facilitate the acquisition by the grantor of rights in that personal property by loaning the money used by the grantor to acquire those rights.



- (b) a perfected security interest in secured property will take priority over an unperfected security interest in the same secured property (Section 55(3)):
- (c) subject to certain exceptions, priority between two or more security interests in the same secured property that are perfected by registration is determined by the order of registration (Section 55(4));
- (d) a security interest in secured property that is perfected by control has priority over a security interest in the same secured property that is perfected by any other means (including by registration) (Section 57(1));
- (e) priority between two security interests in the same secured property that have been continuously perfected by control is determined according to the order in which the security interests were perfected by control (Section 57(2));
- (f) subject to compliance with certain timing requirements for registration, a perfected PMSI will have priority over any other perfected non-PMSI security interest that is granted by the same grantor in the same secured property, except for a security interest that is perfected by control (Section 62):
- (g) a security interest arising under a security agreement will have the same priority in respect of all future advances and obligations secured under the security agreement (Section 58); and
- (h) the transfer of a security interest will not affect its priority (Section 60).

The order of priority of PPSA security interests may also be affected by any inter-creditor agreements or similar agreements and arrangements between secured creditors.⁸

8. Is interest on debt incurred to acquire a company in Australia deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Interest

Interest on debt incurred to acquire a company in Australia is generally tax deductible to the borrower if:

- (a) the interest payments are returns on "debt interests" (not equity interests); and
- (b) the thin capitalization rules are not breached see further below.

Further, transfer pricing rules may also apply to limit debt deductions in some circumstances.

Thin capitalization

Thin capitalization rules may limit debt deductions for entities that are geared in excess of certain thresholds. Under the rules, debt deductions will be denied to the extent a taxpayer's debt level exceeds the "maximum allowable debt" threshold.

The rules apply to Australian entities with the requisite degree of foreign ownership and Australian entities with offshore investments. There is an exemption where the taxpayer's total debt deductions in an income year are less than AUD250,000.

subordination is intended (Section 61(2) PPSA).

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⁸ Under Section 61 of the PPSA, a secured party may (in a security agreement or otherwise) subordinate its security interest in secured property to any other interest in the secured property. Such a subordination will be effective between the parties and may be enforced by a third party if the third party is the person, or one of a class of persons, for whose benefit the



There are a number of tests that can be used to determine whether borrowings fall within the accepted gearing ratio. These are:

- (a) the safe harbor test (which permits a 75% debt-to-equity ratio);
- (b) the arm's length test; and
- (c) the worldwide gearing test (which has regard to the gearing level employed in other jurisdictions).

Advanced law changes

The former Labor Government announced in the 2013 Federal Budget that it will:

- (a) change the safe harbor test to permit a 60% debt-to-equity ratio;
- (b) extend the worldwide gearing test to inbound investing entities; and
- (c) increase the de minimis exemption to AUD2 million.

After being elected, the new Coalition government has confirmed it will proceed with these proposed measures. The proposed measures, if enacted, will apply from 1 July 2014.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Australia?

In deciding whether to honor a contractual subordination, a liquidator or bankruptcy trustee will have to consider three main issues arising in relation to the subordinated debt on the insolvency of the debtor:

- (a) the legal structure of the subordinated debt arrangement;
- (b) whether creditors are required to be treated on a basis; and
- (c) any set-off rights in insolvency.

Subordinated debt structure

There are different structures of contractual subordination. Under the simplest type of contractual subordination, the relevant parties agree that the subordinated creditor does have rights in respect of the debt but that it will simply not exercise them until the senior creditor has been paid in full.

A contractual subordination can also be drafted so that the subordinated debt is contingent debt. As such, the subordinated creditor agrees that it has no rights in respect of repayment of the subordinated debt until the senior creditor has been paid in full. In other words, the rights of the subordinated creditor are contingent or conditional on the senior creditor being repaid.

On first consideration, it appears that the differences between the two forms of contractual subordination are theoretical rather than real; however, each arrangement will be handled differently on the insolvency of the debtor. The particular concern in this context is the operation of statutory set-off rights under Section 553C of the Corporations Act (as discussed below).

Pari passu

Generally, creditors of a company will rank equally in priority, other than creditors having a statutory priority, on the winding up of that company (see Sections 501 and 555 of the Corporations Act).

A line of cases has debated whether debt subordination arrangements would be upheld on the insolvency of the debtor company. In the early 1990s, in what was regarded as a confirmation of the Australian position, Section 563C was introduced into the Corporations Act. Section 563C provides that nothing will render a debt subordination by a creditor of a company unlawful or unenforceable, except so far as the debt subordination would disadvantage any creditor of the company who was not a party to, or otherwise concerned in, the debt subordination.



At a general level, the purpose of Section 563C is to ensure that contractual subordination arrangements are not invalidated merely because of the pari passu rule in Section 555 but are upheld on the insolvency of the debtor. The rationale is that other creditors of the debtor who are not party to the arrangements are unlikely to be disadvantaged by the subordination. However, Section 563C will not protect every subordination arrangement on the insolvency of the debtor. Some of the problems, which still exist, are:

- (a) Section 563C defines, in some detail, the type of debt subordination to which it applies. As a result, the section may not apply to certain existing structures that do not fall within the strict wording of the definition in the section; and
- (b) Section 563C attempts to resolve one issue only, that is, the application of the general pari passu rule in Section 555 to subordinated debt. It does not deal with other issues that also impede the efficacy of debt subordination on the insolvency of the debtor, in particular, the exercise of set-off rights in insolvency by a subordinated creditor.

Statutory set-off

Section 553C was introduced into the Corporations Act in 1992.

In general terms, the section states that a creditor of a company in liquidation can set off debt it owes to the company in liquidation against the debt owed to it. However, the creditor should not be able to claim the full amount due to it from the insolvent company in circumstances where it owes an amount to the insolvent company which it does not pay, or does not pay in full, leaving the liquidator to pursue that creditor separately in respect of such amount.

Section 553C poses a difficulty in the context of subordinated debt arrangements. In any subordination agreement, the senior creditor is likely to require that the subordinated creditor agree not to exercise any rights of set off it might have against the debtor. The intention will be to ensure that part of the subordinated debt is not repaid

without being subject to the subordination arrangement. The accepted view is that compliance with Section 553C is a mandatory provision that is not possible to contract out of. Therefore, this may be of concern to potential senior creditors.

Contingent debt subordination should protect the position of a senior creditor from the adverse consequences of Section 553C. Under a contingent debt subordination, because the subordinated debt is contingent, there will be no debt to set off against amounts owed by the subordinated creditor to the debtor until the senior debt has been repaid. A general contractual debt subordination, on the other hand, does not offer this protection.

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Austria

1. Is there any prohibition on a company incorporated in Austria providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Financial assistance

Under Austrian law, it is generally not permissible for a stock corporation (Aktiengesellschaften) (AG) to provide financial assistance to third parties for the acquisition of its own shares (Section 66a Austrian Stock Corporation Act – Aktiengesetz) (AktG). Agreements entered into in violation of this provision are null and void. Since no corresponding provision exists for limited liability companies (Gesellschaften mit beschränkter Haftung) (GmbH), financial assistance is generally allowed for limited liability companies. However, financial assistance is always subject to capital maintenance provisions that already set out substantive stringent limitations (see next paragraph below). Financing arrangements that contravene Austrian mandatory capital maintenance provisions are at risk of being null and void.

Capital maintenance

Under Austrian law, shareholders in GmbHs and AGs are generally not permitted to reclaim their equity and other financial contributions (Section 82 of the Austrian Law on Limited Liability Companies (Gesetz über Gesellschaften mit beschränkter Haftung) (GmbHG)). The provisions in relation to GmbHs are also applicable to limited partnerships involving limited companies or stock corporations as unlimited partners, i.e., GmbH & Co KG and GmbH &Co AG. Therefore, in general, the repayment of capital to shareholders of a GmbH, GmbH & Co KG, GmbH & Co AG and AG is not permitted under Austrian law. Shareholders are only entitled to:

(a) dividends, i.e., the distribution of the net balance sheet profits of the company or corporation;

- (b) funds and assets received in the course of a formal capital reduction;
- (c) any liquidation surplus, subject to creditor protection provisions; and
- (d) consideration received in arm's length transactions with the company.

Additional payments and benefits received by the shareholders are qualified as being in violation of the Austrian capital maintenance rules and result in the invalidity of the relevant transaction.

It is admissible for shareholders to pledge their shares in the target company and to pledge or assign their claims for dividends. This is particularly relevant in the context of acquisition financing. In this context it should also be mentioned that upstream and cross-stream guarantees and securities are generally permitted in Austria if they do not violate the Austrian capital maintenance rules. As a consequence, upstream and cross-stream guarantees and securities are subject to certain stringent restrictions and are only permissible if, and to the extent that, the granting of the security:

- (a) is commercially justified;
- (b) is at arm's length; and
- (c) does not, if enforced, endanger the solvency of the security provider.

For this purpose, finance documents, such as loan agreements and the related security documents, usually include provisions setting out certain restrictions on the scope and the enforcement of the security (limitation language), which effectively limits the secured parties' security interest and enforcement rights. The limitation language, albeit restricting the value of the collateral, is market standard in Austria



2. What are the implications under the corporate benefits laws of Austria for a company providing financial assistance?

Unlike in many other countries, there are no corporate benefits laws in Austria. However, Austrian courts interpret financial assistance provided beyond the limits of capital maintenance rules, as explained above, as a violation of mandatory law. Therefore, a transaction of this type will be rendered, at least partially, null and void by operation of law. The company's managing directors and/or board members are also at risk of being held liable for having acted negligently. This could in particular be the case if they:

- (a) permitted payments to shareholders which were subsequently deemed to be in violation of capital maintenance rules;
- (b) allowed the granting of security later deemed to be in violation of capital maintenance rules; or
- (c) were involved in the drawing up, or the provision, of incorrect financial statements.

Finally, the Austrian Code of Corporate Governance sets out recommendations to be observed by the management and the supervisory board of Austrian stock corporations.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants or security and if so, what is the basis for calculation?

Securities

In Austria, all main types of assets available can generally be subject to security rights (i.e., tangible and intangible assets as well as movable and immovable assets). In general, the provision of security (pledges or security assignments) does not have to be registered with public registers. Exceptions apply, however, for mortgages that must be registered in the land register to be valid, as discussed below.

To validly create a security interest in each case:

- (a) a security agreement needs to be drawn up; and
- (b) the relevant steps required to perfect the security interest need to be carried out (e.g. the handing over of the asset, the attachment of placards, book annotation, notification of debtors).

Security packages usually also include security provided by third parties, typically in the form of guarantees (*Garantie*) or suretyships (*Bürgschaft*).

The most common securities granted over assets in Austria are set out below

Pledges over movable assets and claims

General

A pledge is a way of creating security by delivering an asset to a creditor to hold until an obligation of the debtor is performed. Although the creditor takes possession of the asset, the debtor retains ownership. Therefore, the creditor can only sell the pledged asset if the obligation is not performed. It is also possible to grant a pledge over claims.

A pledge over movable assets requires:

- (a) a pledge agreement between the pledgor and the pledgee; and
- (b) perfection.

Perfection

Perfection is effected by handing over the pledged assets to the pledgee or by otherwise transferring control over the assets



(Verfügungsgewalt) to the pledgee. In practice, pledges over movable assets are not commonly used because the pledgor would have to give up possession of the assets to be pledged, which is usually not practical as the assets are, in most cases, required for the continuation of the pledgor's business. In the case of a pledge over claims, the pledge is generally perfected by means of notifying the third party debtor.

Share Pledge

Under Austrian law, the granting of a share pledge is also permissible. For share pledges, the type of entity in which the shares are being pledged determines the required act of perfection. In the case of certified shares (applying, in particular, to stock corporations) an actual physical transfer of the documents is required. The transfer can be effected by means of:

- (a) an endorsement of the share certificates; and
- (b) physical delivery.

For limited liability companies, no actual shares are issued. Instead, the share only exists in legal terms as a right in the company. Therefore, the rules in relation to the pledge of rights apply and the perfection requires the notification to the company whose shares are to be pledged.

Account pledge

Account pledges are often provided as collateral in Austria. The pledgor pledges the balance on a particular bank account for the benefit of the creditor. The pledge agreement is entered into between the debtor and the creditor. However, it only becomes effective when the relevant account bank is notified of the pledge. Usually, the parties agree that the debtor is entitled to operate the account in the ordinary course of business until an event of default has occurred.

Pledge over receivables

A pledge over receivables is also commonly used in financing transactions in Austria. Neither a pledge of receivables nor a security assignment is subject to registration in a public register. In addition, neither of these is subject to a specific formal requirement under Austrian law. The act of notification required for the perfection of the receivables pledge is the same as required in case of a security assignment (discussed below).

Pledges over immovable assets

Pledges over immovable assets of the borrower, i.e., mortgages (*Hypothek*), are common, in particular, in project finance and real estate finance transactions as they are considered the most valuable security for the lender.

To be effective, the mortgage needs to be registered in the land register held with the relevant court. The registration generally involves additional costs, such as notarial fees and court fees. The registration of the mortgage in the land register triggers a registration fee of 1.2 % of the secured (maximum) amount. Additionally, a mortgage agreement, unless determined to be collateral in the context of financing arrangements (as mentioned below), is generally subject to Austrian stamp duty calculated at the rate of 1.0 % of the consideration (Section 33 TP 18 GebG). The ranking of the mortgage largely depends on when the registration application (accompanied by all required documents, in particular the mortgage agreement) was filed with the competent court.

Under Austrian law, when enforcing the pledge, the transfer of real estate is subject to property transfer tax (*Grunderwerbsteuer*) at a rate of generally 3.5 % of the consideration.

Security transfer (Sicherungsübereignung)

In a security transfer, while ownership is transferred from the debtor (as transferor) to the creditor (as transferee), the transferee is



nevertheless required to hold the property on trust for the transferor. Therefore, full ownership falls back to the transferor when it has fully settled the secured obligations. For the perfection of the security agreement, the transferred assets need to be physically handed over to the transferee. Due to its burdensome structure, the security transfer is rarely used in financing transactions in Austria.

Security assignment (Sicherungszession)

In the course of a security assignment, the debtor (as assignor) assigns its claims against a third party to the creditor (as assignee). For this type of assignment to be valid and enforceable, the debtor has to either:

- (a) disclose the assignment to the third party whose claims are subject to the assignment; or
- (b) mark the claims, in its physical and electronic books and records, as being assigned for security purposes.

If the debtor defaults, the creditor will usually disclose the assignment and seek payment directly from the third party. Assignment contracts are generally subject to stamp duty at the rate of 0.8 % of the consideration (Section 33 TP 21 Para 1 GebG). Exemptions to this stamp duty imposition apply in particular in relation to financing arrangements (see the answer in the paragraph "Stamp duty and court registration fees" below) as well as to assignments between credit institutions and assignments to special securitization companies (for details see Section 33 TP 21 Para 2 GebG).

Suretyships/guarantees

Austrian law distinguishes between personal guarantees, also referred to as suretyships, and abstract guarantees. Personal guarantees are conditional securities, which means that they are only valid if and to the extent the obligation to be secured is in place. Abstract guarantees are abstract and, therefore, independent of the underlying obligation to be secured

Personal guarantee

By a personal guarantee or suretyship (*Bürgschaft*) the guarantor undertakes to settle certain obligations of a debtor if the debtor fails to effect a payment when due. The personal guarantee is a security in *personam* and *accessory*. This means that the guarantor's liability is conditional on:

- (a) the existence of the debtor's obligation (in terms of validity as well as in terms of the amount of the obligation); and
- (b) the debtor's failure to fulfill its obligation.

Suretyships are only used rarely to secure third party obligations in Austria.

Accession to joint liability

An accession to joint liability (*Schuldbeitritt*) is also a security in *personam* and *accessory*. Here, the provider of collateral joins the agreement between the debtor and the creditor by acceding to the obligation of the debtor. The accessor may either join the agreement as an additional debtor or replace the original debtor. The replacement of the original debtor requires the consent of the creditor.

Abstract guarantee

By an abstract guarantee, the guarantor undertakes to pay a certain sum on the beneficiary's formal request without having the right to raise objections on the merits of the request. In this respect, the guarantee is similar to a documentary letter of credit. The guarantor's payment obligation is abstract (as opposed to being accessory as is the case with suretyships) in the sense that it is independent from the underlying legal relationship between the creditor (as beneficiary) and his debtor. Therefore, when the guarantor receives a request for payment from the creditor, it may not raise any defenses resulting from the underlying commercial transaction between the creditor and the debtor. The guarantor may only contest the creditor's claim in case of an abuse of rights by the creditor.



Stamp duty and court registration fees

Certain security agreements trigger stamp duty under the Austrian Stamp Duty Act (Gebührengesetz) (GebG). Stamp duty generally amounts to 0.8 % of the value of the collateral in the case of assignments or 1.0 % of the value of the collateral in the case of suretyships (Section 33 TP 7 and 21 GebG). By contrast, stamp duty is generally not imposed on security provided as collateral in the context of financing arrangements (Section 20 Item 5 GebG).

Mortgages trigger a court registration fee calculated at 1.2 % of the secured amount

4. How long, following acquisition of a foreign target company, would it usually take in Austria for a local Austrian subsidiary of that foreign target company to grant a guarantee/security?

There is no statutory waiting period for an Austrian subsidiary to issue a guarantee or to grant security. Therefore, Austrian subsidiaries may generally provide security immediately on completion of an acquisition. However, the actual time period for the granting of security will depend on whether statutory law or the relevant company's articles of association contain any specific requirements in relation to the granting of the security. The relevant provisions could, in particular, call for a board resolution and its related formal requirements, such as the necessity of the resolution to be drawn up as a notarial deed

Registration requirements for the guarantee or security (as the case may be) also may exist.

5. Are there any restrictions on foreign banks lending to companies in Austria? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

A foreign bank lending in Austria may become subject to Austrian regulatory regimes and licensing requirements, in particular under the Austrian Banking Act (*Bankwesengesetz*) (**BWG**) and the Capital Requirements Regulation (**CRR**), if it conducts banking business or provides financial services in or cross-border into Austria.

Under Section 1 Para 1 Item 3 of the BWG, the conclusion of moneylending agreements and the granting of monetary loans (lending business) generally require a banking license. Moreover, a foreign credit institution (i.e., an institution authorized to conduct business in accordance with the legal provisions of its country of establishment which is not an EU Member State) requires a license to operate a branch in Austria. If the foreign bank only engages in money-lending business from abroad (i.e., without setting up a branch in Austria), the decisive factor for assessing whether or not the licensing requirement is triggered is generally the manner in which the business relationship with the (Austrian) customer is initiated. If the foreign entity specifically targets customers with registered offices or ordinary places of residence in Austria for the purpose of offering its services to them repeatedly and on a commercial basis, Austrian authorities will generally assume that the lending services are rendered in or cross-border into Austria. Therefore, a licensing requirement will be triggered.

Withholding tax

Typically interest payments to foreign banks are not subject to withholding tax. However, in Austria, a new regulation was recently introduced that extends Austrian non-resident taxation to Austrian source interest income. Therefore, as of January 1, 2015, interest paid by an Austrian paying agent or Austrian depository to an investor resident abroad is subject to withholding tax at the rate of 25%.



However, the Austrian law also provides for some exemptions to the obligation to deduct the withholding tax. Moreover, exemptions may also be stipulated in the applicable double tax treaty.

Under Austrian law, corporate investors may avoid the application of Austrian withholding tax by filing a declaration of exemption (Befreiungserklärung) (Declaration) under Section 94 Item 5 of the Austrian Income Tax Act (*Einkommensteuergesetz*) (**EStG**). In the Declaration, the foreign corporation, amongst other things, must confirm that the interest income is operating revenue.

Further, interest payments made by Austrian credit institutions to foreign credit institutions are not subject to Austrian withholding tax (inter-banking exemption). The same applies to interest payments under a loan agreement that is neither a banking transaction (e.g., inter-company loans between non-credit institutions) nor securitized. In relation to interest payments from an Austrian non-credit institution to a foreign credit institution, currently the prevailing legal opinion is that these transactions should also not qualify as banking transactions within the meaning of the withholding tax provisions of the EStG and, therefore, be exempted from Austrian withholding tax. However, due to a lack of guidance from the Austrian legislator and tax authorities on the new non-resident taxation regime, some level of legal uncertainty remains. To be on the safe side in relation to the nonapplication of Austrian withholding tax, foreign banks may nevertheless opt to file a Declaration under Section 94 Item 5 EStG.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Austria, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Public Takeovers in Austria are regulated by the Takeover Act (Übernahmegesetz) (Takeover Act). The Takeover Act, which is enforced by the independent Takeover Commission, sets out fundamental principles of takeovers. The principles include, in particular, an equal treatment of all shareholders, transparency

throughout the bidding process and the avoidance of market manipulation.

In this regard, the Takeover Act also stipulates that the bidder may only publish his intention to make a bid after he has made sure that he can pay the price offered in full. If the price will be financed by means of a bank loan, the Takeover Commission, in general, requests the submission of a relevant confirmation from the lending bank to confirm that there will be sufficient funding.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

The order of priority of creditors in an insolvency under Austrian law (i.e., the Austrian Insolvency Act (*Insolvenzordnung*) (**IO**)) is generally as set out below.

Preferential creditors (Massegläubiger)

Under Sections 46 and 47 of the IO, creditors with claims that arise during the insolvency proceedings in relation to the insolvency proceedings and the assets involved in those proceedings, i.e., preferential creditors (*Massegläubiger*), enjoy preferential treatment. This means that their claims rank before the claims of all other insolvency creditors and that their claims are settled in full, unless the insolvency estate lacks sufficient funds. In that case, a specific order of priority in relation to preferential claims applies. In particular, all claims for costs and expenses for the insolvency proceedings are paid from the insolvency estate first. Secondly, all costs and expenses in relation to the conservation and management of the estate are paid. Thirdly, claims in relation to the payment of wages or salaries of the insolvent entity's employees (from the time after the commencement of the insolvency proceedings) are paid. Claims arising out of bilateral agreements during the term of the insolvency proceedings rank fourth. if the insolvency administrator chose their continuance, and all claims arising from legal acts of the insolvency administrator rank fifth.



Secured creditors (Absonderungs- und aussonderungsberechtigte Gläubiger)

Under Section 48 of the IO, creditors with e.g., a lien or another type of in rem security interest are entitled to separate satisfaction of their debts against the insolvency estate (Absonderungsrecht). To the extent that the security provided is not sufficient to cover the total amount of the secured claim, the remaining claim is generally treated as an unsecured insolvency claim (see below). However, creditors who only obtained an in rem security interest within 60 days of the commencement of the insolvency proceedings are generally not entitled to payment as a secured creditor.

A creditor who holds a right in rem or a right in personam and can prove that a particular asset does not form part of the insolvency estate because of that creditor's right is entitled to exercise a right of segregation (Aussonderungsrecht) under Section 44 of the IO. This applies, in particular, to ownership rights as well as to retention of title agreements (Eigentumsvorbehalt). Creditors with these segregation rights do not have to take part in the insolvency procedure. They are usually able to fully recover their assets.

Unsecured creditors (Insolvenzgläubiger)

All creditors with claims that are unsecured and that have already been in existence at the time of the commencement of the insolvency proceedings fall under this category. These insolvency creditors are paid on a pro rata basis under Section 50 of the IO only after the claims of all preferential creditors and secured creditors are satisfied. The uniform percentage of each claim to be paid (known as the "insolvency quota") is calculated by the liquidator at the end of the insolvency proceedings.

Subordinated creditors (Nachrangige Gläubiger):

Once all of the preferential or secured claims (as mentioned above) and non-secured claims are satisfied, claims under the Act on Equity Substitution (*Eigenkapitalersatzgesetz*) (**EKEG**) must be fulfilled

under Section 57a of the IO. Under the EKEG, a shareholder's claim for the repayment of a loan that it granted to the subsequently insolvent company is at risk of being subordinated to the claims of unsecured creditors. This particularly applies in cases when the loan was granted when the company was either:

- (a) illiquid;
- (b) over-indebted; or
- (c) cannot meet certain financial covenants (i.e., a debt-to-equity ratio of at least 8 %, a notional debt repayment period not exceeding 15 years and no re-organization required).

In these circumstances, the loan is treated like all other equity. Austrian law also gives parties the option to enter into a subordination agreement. As mentioned previously, these claims (either by contractual agreement or by law under Section 57a of the IO) will only be satisfied in the unlikely event that all higher-ranking claims are entirely satisfied (see also the answer to question 9).

8. Is interest on debt incurred to acquire a company in Austria deductible from earning for tax purposes? Are there any thin capitalization thresholds?

If the acquirer is subject to Austrian resident taxation, the costs of acquiring a company are generally deductible to the extent that they qualify as operating expenses. This means that interest on debt incurred (*Fremdkapitalzinsen*) for acquiring a company in Austria, irrespective of whether the acquisition is structured as an asset deal or as a share deal, is, generally, tax deductible and reduces the acquirer's taxable income in Austria.

For share deals, however, Austrian law stipulates certain further restrictions on the deductibility of interest on debt incurred. In particular, interest on loans in connection with the acquisition of shares in affiliated companies is not tax deductible. Further, interest



payments made to an affiliated company that are not taxable or subject to taxation of less than 10% at the level of this affiliated company are not tax deductible

There are no specific thin capitalization rules in Austria. Nevertheless, according to the administrative practice of Austrian tax authorities and Austrian case law, a shareholder loan may be reclassified as equity on a case-by-case basis. For this purpose, in particular the terms of the shareholder loan (including its compliance with the arm's length principle) and the economic situation of the company will have to be considered. In relation to the economic situation of the company, the adequacy of the company's equity ratio is also taken into account. For example, in a decision of the former Austrian Independent Financial Tribunal (Unabhängiger Finanzsenat) from 2012, an equity ratio of 25% was considered adequate. However, in that case other factors (in particular compliance with the arm's length principle) were also decisive

If the court reclassifies a shareholder loan as equity (e.g., because the equity ratio is deemed inadequate), the relevant portion of the liability to the shareholders will be deemed to be the shareholders' equity. Therefore, the liability will not be considered for tax purposes and, in particular, interest payments on the loans will not be deductible. Instead, they will be treated as disguised dividends.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Austria?

Austrian law recognizes the concept of "contractual freedom". This does not only mean that contracts are based on the mutual agreement of the parties involved. The respective parties are also entitled to choose the design of the contract they wish to enter into freely within the framework of Austrian mandatory laws. While there is no specific mandatory law on contractual subordination in Austria, a contractual subordination agreement will generally be honored by a liquidator in an insolvency under Austrian law. Therefore, a claim which, under the applicable contractual agreement, is subordinated to other claims will

fall within the group of subordinated claims of subordinated creditors (see the answer to question 7). The subordinated claim will rank according to the contractual agreement.

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Belgium

1. Is there any prohibition on a company incorporated in Belgium providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Under Belgian law the principle is that several types of companies, including each limited liability company incorporated as an SA/NV or SPRL/BVBA (which are the two most common types of commercial companies) may not advance funds, grant loans or provide security "in view of" the acquisition of its shares or its profit certificates by third parties, or "in view of" the subscription by third parties to certificates relating to those shares or profit certificates.

Although financial assistance is not prohibited if certain conditions are met and a statutory procedure is followed, the scope of these conditions is so onerous that the procedure is rarely applied in practice. Therefore, financial assistance should be considered prohibited under Belgian law.

According to the majority of legal scholars, as confirmed by recent case law of the Belgian Supreme Court (Hof van Cassatie/Cour de Cassation), the prohibition should be construed restrictively. Therefore, as the Belgian Companies Code contains a limited list of prohibited transactions, other transactions not mentioned above should not be considered to fall within the scope of the prohibition on financial assistance. This means that the purchase by a company of its own shares, distribution of dividends, reduction of capital, repayment of capital, distribution of reserves and the payment for goods or services at market price should not fall within the scope of the prohibition on financial assistance. In line with the restrictive interpretation of the prohibition on financial assistance, the majority of legal scholars consider that Belgian subsidiaries of the target company are not caught by the prohibition either, as neither their shares nor their profit certificates change hands.

Even if the financial assistance rules are not considered to be applicable to a particular transaction, parties should still take into account that other general corporate rules (e.g., corporate purpose and corporate interest requirements) or tax rules may apply.

Furthermore, the case law of the Belgian Supreme Court does not address all uncertainties that have arisen in the past regarding the prohibition of financial assistance. For example, in the past, a judge ruled that security provided by a target company to secure a credit facility entered into to finance the distribution of dividends by that target company could be a prohibited form of financial assistance. Applying the recent decision (mentioned above) of the Belgian Supreme Court, the credit facility financing the distribution of dividends should not be considered to be a prohibited form of financial assistance. However, that decision does not clarify whether or not the security granted to secure the credit facility financing the distribution of dividends might be a prohibited form of financial assistance.

The sanctions in relation to a violation of the prohibition on financial assistance are the following:

- (a) the prohibited transaction can be declared null and void;
- (b) the directors, the auditors and advisers who advised the parties to structure the transaction in a way involving a violation of the prohibition on financial assistance could be held civilly liable; and
- (c) possible criminal penalties for the persons violating the prohibition.
- 2. What are the implications under the corporate benefit laws of Belgium for a company providing financial assistance?

As a general rule, Belgian law restricts a Belgian company from encumbering its assets (as security or otherwise) or giving



undertakings (including, but not limited to, guarantees) for the benefit of other parties (including, but not limited to, its parent or affiliated companies) (Third Party Support Transaction). For the avoidance of doubt, this includes providing financial assistance.

Although there is little case law about Third Party Support Transactions, they have been upheld if they are within the corporate purpose of the grantor and meet the so-called "corporate interest test".

Whether a Third Party Support Transaction is in the grantor's corporate interest must, in principle, be considered on an individual basis. However, authoritative case law and legal writings have held that, within a group of companies, the corporate interest of each entity should to a certain extent be tempered by taking into account the interests of the group.

A Third Party Support Transaction may be held to be in the grantor's corporate interest where it can be shown that:

- (a) the grantor itself derives a benefit from entering into the Third Party Support Transaction (e.g., because part of the borrowings will be used, directly or indirectly, by it, or more advantageous credit terms can be obtained at the group level);
- (b) the grantor's financial liability under the Third Party Support Transaction is not disproportionate to its financial means nor to the benefit it derives from the Third Party Support Transaction; and
- (c) the grantor is a member of a structured group with a common economic interest, and not a mere temporary and occasional group interest

Only the board of directors can properly assess whether these conditions are met. If these conditions are not met, the Third Party Support Transaction would be deemed contrary to the grantor's interests. However, Belgian case law does not offer clear guidelines in relation to when a group transaction is within the corporate interest and when the proportionality test is met.

A Third Party Support Transaction (including financial assistance) entered into without satisfying the "corporate interest test" could be held to be null or unenforceable.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Types of security

The most typical types of security granted in Belgium include:

- (a) pledges over shares;
- (b) pledges over receivables and bank accounts;
- (c) pledges over intellectual property;
- (d) floating charges over the business of a company; and
- (e) mortgages over property located in Belgium.

Technical requirements

Pledge

Under Belgian law, to create a valid and enforceable pledge, the possession of the pledged asset should in principle be transferred to the security beneficiary or a third party pledgeholder. For this reason, pledges over individual tangible movable assets are used in limited circumstances, as the dispossession requirement impedes the pledgor's ability to use the assets and therefore often makes this type of pledge impractical.



Pledge over shares

For registered shares, the dispossession is achieved by recording a statement in the share register of the relevant company. If the pledge relates to dematerialized shares, the shares must be transferred to a pledged account controlled by the pledgee or its representative.

Pledge over receivables and bank accounts

For pledges over receivables and bank accounts the dispossession is realized by execution of the pledge agreement. However, to be enforceable against the debtor of the pledged receivables and the account bank, these parties must be notified of the pledge.

Pledge over intellectual property

The perfection requirements of pledges over intellectual property depend on the type of intellectual property being pledged, and consist of notifications and/or registrations.

Floating charge

Floating charges over businesses should be registered with the competent mortgage office to be enforceable against third parties. For registration purposes, floating charge agreements should be drafted in Dutch or French.

Mortgage

Mortgages are to be incorporated in notarial deeds and must afterwards be registered by the notary with the mortgage office. Furthermore, mortgage deeds must be drafted in Dutch or French (or German) for registration purposes.

Tax and duties payable

A nominal stamp duty of EUR 0.15 is due on each original security agreement executed in Belgium and securing obligations owed to a bank

Floating charges over businesses are subject to a registration duty equal to 0.5% of the secured amount (which should be determined in the floating charge agreement) and mortgage officer's fees.

Mortgages are subject to a registration duty equal to 1% of the secured amount (which should be determined in the mortgage deed), a mortgage duty equal to 0.3% of the secured amount, notary fees and mortgage officer's fees.

To avoid the costs connected with floating charges over business and mortgages, it is market practice in Belgium to limit the amount secured by floating charges and mortgages and to grant mandates allowing the taking of a floating charge over a business or a mortgage on property at a later stage without further intervention of the security provider being required. However, these mandates do not provide the beneficiary with a priority right until the mandate is actually converted into a floating charge or mortgage respectively.

New Act on security over movable assets

In 2013, the Belgian Parliament introduced new legislation dealing with security over movable assets, which should in principle come into force by no later than 1 January 2017.

One of the changes is that dispossession will no longer be required as a prerequisite to create a pledge over movable assets. While it will continue to be possible to perfect a pledge by way of dispossession, it will in the future also be possible to achieve perfection by registering the pledge in a pledge register. This increases the class of assets available as collateral, since it will in the future be possible to pledge certain tangible assets that (in practice) could not be pledged before due to the dispossession requirement.

Another important change is that a pledge over any floating pool of assets will be possible, while currently it is only possible to grant a floating charge in respect of the entire business of a company. Furthermore, it will also be possible to pledge all the inventory of a



company (whereas currently floating charges on a business only cover, as part of the business being pledged, 50% of the inventory).

Although the new Act increases the available security possibilities, the practical consequences of the Act are not vet known. The registration of pledges will be subject to a registration cost, and if that cost is significant, parties may still prefer to perfect pledges by way of dispossession.

4. How long, following acquisition of a foreign target company, would it usually take in Belgium for a Belgian subsidiary of that foreign target company to grant a quarantee/security?

Under Belgian law there are no legal requirements that prevent a subsidiary of a target company from granting a guarantee or security on the same day as the target company is acquired.

The timing will mainly depend on the time that is necessary to draft the necessary documentation and the availability of the directors and shareholders of the subsidiary to sign the necessary resolutions. If the documentation is prepared prior to the acquisition and the directors and shareholders are available on the date of the acquisition, the subsidiary can grant a guarantee and security on that same day.

If a mortgage is to be granted, the notary will have to notify the tax authorities at least 12 business days before execution of the mortgage, and will have to conduct certain searches in the mortgage register. However, if the notary is instructed in time, these obligations should not delay the process of granting guarantees or security by the subsidiary, because they can (at least in theory) be done pre-closing.

5. Are there any restrictions on foreign banks lending to companies in Belgium? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

Specific "conduct of business" rules apply when providing credit in Belgium, notwithstanding the capacity of the borrower (although the rules are more stringent when the borrower is a small or medium-sized enterprise).

To the extent a credit institution:

- (a) only provides credit for its own account; and
- (b) does not take deposits or other repayable funds from the public in Belgium,

it is accepted practice that no registration or license is required.

Withholding tax

Under Belgian tax law, a 27% withholding tax is in principle due on all interest payments made by Belgian corporate taxpayers. However, there are a good number of (treaty and domestic) exemptions.

A specific (domestic) exemption in relation to withholding tax is provided for interest payments to credit institutions that are established in the European Economic Area (**EEA**) or in a country with which Belgian has signed a tax treaty. Those interest payments can be made without any Belgian withholding tax.



6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Belgium, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Prior to the public announcement of the takeover bid, the bidder must provide evidence to the Belgian Financial Services and Markets Authority that it has the necessary funds for the takeover bid.

If the takeover bid relies on bank debt, the necessary amounts should be available as an irrevocable and unconditional credit facility granted to the bidder by a Belgian credit institution. This means that there cannot be any condition precedent to drawdown that would make the availability of the funds to the bidder uncertain. Furthermore, the bidder will have to show to the Financial Services and Markets Authority that the availability period of these "certain funds" will allow the bidder to pay the accepting shareholders.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Under Belgian law debt holders are given priority over equity holders.

The order of priority among the debt holders is in the following descending order:

- (a) secured creditors, being creditors who are the beneficiaries of a mortgage or a pledge;
- (b) creditors in relation to debts incurred by the liquidator as administrator of the assets of the debtor after the debtor has been declared bankrupt (including debts incurred, after the debtor has been declared bankrupt, from the performance by third parties of their obligations under existing agreements); and

(c) unsecured creditors (including secured creditors to the extent their debts are not fully discharged after enforcement of their security rights).

However, several legal privileges exist under Belgian law that give certain creditors priority over other creditors (including, in certain circumstances, secured creditors). For example, legal costs (including, among others, the liquidator's fees and enforcement costs) and costs to preserve assets of the debtor will rank ahead of the debts owed to creditors who benefited from these costs

Furthermore, the Belgian tax authorities benefit from a legal mortgage, the ranking of which will only be determined upon registration of the mortgage. This could be particularly relevant when a creditor has been granted a mortgage mandate. As mentioned in the answer to question 3, a mortgage mandate does not create a security right: a security right will only be created on conversion of the mandate into a mortgage. Therefore there is a risk that the mortgage mandate will be converted at a time when the tax authorities have already registered their legal mortgage. In those circumstances, the mortgage of the creditor created from the conversion of the mortgage mandate will rank behind the mortgage of the tax authorities.

8. Is interest on debt incurred to acquire a company in Belgium deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Interest incurred by Belgian corporate taxpayers in relation to the acquisition of shares is generally tax deductible under the standard conditions for deduction of costs.

Belgian tax law contains a general thin capitalization rule providing for a 5:1 debt/equity ratio. Any interest paid on the amount of debt exceeding that ratio is not tax deductible. This thin capitalization rule applies to:



- (a) all loans under which the beneficiary of the interest is not subject to income tax or is subject to a tax regime which is manifestly more favorable than the Belgian tax regime; and
- (b) all intra-group loans.

The equity amount for the above 5:1 debt/equity ratio is defined as the sum of the borrower's taxed reserves (retained earnings and other reserves which are subject to tax) at the beginning of the taxable period and the paid-up capital at the end of the taxable period.

The above 5:1 debt/equity ratio does not apply to loans granted by financial institutions (e.g., bank loans), bonds and other debt instruments issued through a public offering. In addition, the thin capitalization rule excludes certain companies from its scope; i.e., leasing and factoring companies and companies involved in a publicprivate partnership.

Treasury centers are, under certain conditions, allowed to net intragroup interest paid against the intra-group interest received before applying the thin capitalization rule and the limited interest deduction resulting from the netting.

The above thin capitalization rules might have to be amended under the implementation of the OECD outcome on BEPS Action 4 and a foreseen EU Anti-Tax Avoidance Directive, which generally propose a 30% interest to EBITDA ratio above which interest is not longer tax deductible.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Belgium?

Under Belgian law, contractual subordination agreements are considered to be valid and enforceable between the parties to them. Subordination agreements cannot limit the rights of third party creditors but, according to Belgian legal scholars, the existence of subordination agreements and the consequences of them between the parties to the subordination agreements are enforceable against third

parties (including a liquidator). Therefore, on the insolvency of a Belgian debtor, existing subordination agreements will have to be taken into account by the appointed liquidator.

If the liquidator does not honor an existing subordination agreement, the senior creditors are, in principle, protected by the turnover clauses in the subordination agreement. These clauses oblige the junior creditors to transfer the moneys received in violation of the subordination agreement to the senior creditors.

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Brazil

 Is there any prohibition on a company incorporated in Brazil providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

There are no specific restrictions under Brazilian statutory laws on a company incorporated in Brazil providing financial assistance in relation to acquiring its own shares or the shares of its parent company. However, financial assistance may be construed as an abuse of the power of a controlling shareholder if, in general terms, it is:

- (a) approved or caused to be approved by the controlling shareholder and is not given in the best interests of the company; or
- (b) performed under conditions unfavorable to the company and different from conditions available in the market for similar transactions
- 2. What are the implications under the corporate benefit laws of Brazil for a company providing financial assistance?

There are no corporate benefit laws in Brazil to guide a company when providing financial assistance. Brazilian laws do impose certain limitations on the managers, officers and/or directors of companies and corporations, as the case may be (**Administrators**) when undertaking obligations on behalf of those companies and corporations.

Administrators may face civil and/or criminal liabilities in relation to the performance of their duties.

Law 6,404/76, as amended from time to time (**Corporations Law**), sets out detailed rules in relation to civil liability of Administrators. Article 158 of the Corporations Law states that an Administrator will

not be held personally liable for the obligations undertaken on behalf of the corporation in the performance of regular managerial acts. However, the Administrator will be liable for damage arising from acts performed within one's attributions or powers through negligence, willful misconduct or in violation of the law or the company's articles of association or bylaws.

In the performance of their duties, Administrators owe a duty of loyalty and of care, and therefore need to act in the best interests of the company.

If an Administrator is found to be civilly liable for damage to a company:

- (a) the "corporate veil" of the corporation may be "pierced" if there is an abuse of form, by way of deviation from the corporation's purpose or confusion between the assets of the corporation and those of its Administrators or shareholders; 9 and
- (b) the Administrator's personal assets may be seized to seek to remedy the damage caused.

If an Administrator is found to be criminally liable he/she may be punished for the relevant acts that are considered to be a crime according to criminal laws.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

In Brazil, there are two different types of security that may be granted by a debtor or a third party willing to grant a guarantee for the debtor's benefit:

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⁹ Section 50 of the Civil Code (Law no. 10,406 dated January 10, 2002).



- (a) personal security; and
- (b) security in rem.

Personal Guarantee

By means of a personal guarantee, an individual or a legal entity commits to pay the obligations of another person (Main Debtor), if the Main Debtor does not comply with its obligations.

There are two types of personal guarantees used in Brazil, namely the fiança and the aval. The aval is applicable to promissory notes and other negotiable instruments, whereas the *fiança* is granted in relation to contracts in general (in a separate instrument or by means of specific clauses in a contract entered into by the Main Debtor and its creditor or potential creditor). Both types of personal guarantee, like any other security, are accessory (subsidiary) to the main obligation (undertaken in the negotiable instrument or in the contract, as the case may be).

The *fiança* may be granted after or before the guaranteed obligations have been created. If created earlier, the *fiança* will be conditional on the creation of the (future) guaranteed obligations.

In the case of an individual who is married, his/her granting of the fianca or aval must be authorized by his/her spouse in order to be valid and enforceable. Therefore, if the guarantor is a married individual, the guarantor's spouse must also execute the agreement and, in the case of an aval, the spouse must also sign the relevant negotiable instrument.

One of the guarantor's rights under the *fiança* is the so-called "benefit of order." The Brazilian Civil Code (Law no. 10,406 dated January 10, 2002) (Civil Code) provides that a guarantor who is called to honor the guarantee by discharging the debt of the guaranteed party is entitled to demand that the debtor's goods be seized first. This right may however be expressly waived by the guarantor in the fiança agreement. When choosing this type of security (i. e. personal

security), it is important and advisable to evaluate the guarantor's assets to make sure that there are enough assets to provide for payment of the debt in the event of a debtor's default. Note, however, that the guarantor may, in the normal administration of its assets, sell, negotiate or enter into any other type of transaction in relation to its assets, the result of which would be that the guarantee could end up being effectively worthless.

Security in rem

Under a security *in rem*, the securing party grants security over certain asset(s) to serve as collateral. The Civil Code regulates three types of security *in rem*: pledge, mortgage and *anthicresis*.

Mortgage

A mortgage is defined as a right over a real estate asset granted by a debtor (or by a third party on the debtor's behalf) in favor of the creditor to secure payment of a certain debt. The owner of the mortgaged property may grant a further mortgage over the same property in favor of another creditor (with that second mortgage referred to as a "second-degree mortgage"). That is only possible, however, if the value of the mortgaged property exceeds the total amount of debt, if the first mortgage does not preclude the granting of a subsequent mortgage and if the second mortgage deed expressly mentions that it is subject to the first, prior mortgage.

If a debt is not paid, a creditor secured by a mortgage may, in a proper collection lawsuit (or other applicable action), request the attachment of the real estate, to have the court seize it and sell it (in a public auction), applying the proceeds of the sale for the payment of the debt.

A mortgage must be executed in the form of a public deed prepared by a Public Notary Officer. Also, and as a condition of enforceability against third parties, the document must be registered at the relevant Real Estate Registry. A variable percentage amount on the stipulated value of the mortgaged property will be charged at the time of



execution of the mortgage deed and on its registration at the Real Estate Registry.

Pledge

A pledge consists of the delivery of movable property by a debtor (or by a third party on the debtor's behalf) to the creditor as collateral for the debt. As with any other security agreement, the pledge agreement must describe the total amount owed, the terms of repayment, the interest rate (if applicable), and a detailed description of the pledged assets. The agreement must be registered at a relevant Notary Public (which is determined by the type of pledged assets and where they are located). Pledges of company shares must also be registered in the company's book of registration of shares. Certain assets (e.g., vehicles) may also require registration of the pledge with the appropriate regulatory agency.

Anthicresis

In the case of an *anthicresis*, the debtor transfers possession of real estate (collateral) to the creditor, who receives the profits from that collateral, up to the amount of the debt. The creditor is also not allowed to dispose of the real estate that is the subject of the anthicresis.

Fiduciary Assignment

Under a fiduciary assignment (alienação or cessão fiduciária), the debtor effectively transfers to the creditor part of its property rights over a given asset. The creditor then becomes vested with the socalled "reversible ownership" of the asset, and its restitution to the debtor is conditional on the satisfaction of the secured obligation. Possessory rights over the secured asset, however, remain with the debtor.

Brazilian law generally provides for the possibility of creating fiduciary security over movable assets (the legal regime in respect of which varies depending on whether they are fungible and nonfungible assets), real estate assets, and rights over movable and real estate assets or credit instruments.

The main benefit of the fiduciary assignment is that, on default by the debtor, the "reversible ownership" becomes a definitive ownership and the creditor may sell the asset in satisfaction of its debt (to the extent that it follows certain detailed procedures). Debts guaranteed by fiduciary assignments are not subject to bankruptcy (assuming that the asset granted as security under the fiduciary assignment is enough to cover all of the debt; any balance may be subject to the priority order of payment set out in Law 11,101/2005 (Bankruptcy Law)).

4. How long, following acquisition of a foreign target company, would it usually take in Brazil for a Brazilian subsidiary of that foreign target company to grant a guarantee/security?

The length of time it will take for a Brazilian subsidiary to grant a guarantee/security depends on the type of guarantee/security that the Brazilian subsidiary will grant and where the asset is located. In general terms, the formalization and perfection of a personal guarantee may be finalized within five to 10 days, whereas the formalization of a security *in rem* or a fiduciary assignment may take between 15 to 60 days. In this timing estimate the verification of the capacity of the guarantor and all registrations, if applicable, are assumed.

5. Are there any restrictions on foreign banks lending to companies in Brazil? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

There are no restrictions on foreign banks lending to companies in Brazil. Loans made in foreign currency granted by foreign lenders to Brazilian companies or individuals must be electronically registered with SISBACEN in the ROF module (Declaratory Electronic Register of Financial Operations). The conditions for the payment of principal



and the interest rate must not be considered excessive under the Brazilian Central Bank's policies in force at the time of the loan.

The Brazilian company must register the financial terms and conditions of the loan in the ROF module, so that it may enter into a foreign currency exchange agreement with its bank to receive, in Brazilian currency, the equivalent amount disbursed abroad by the lender. It is worth mentioning that the banks in Brazil are not permitted to open bank accounts for their customers, whether individuals or legal entities, in currencies other than the Brazilian currency ("Real" or "Reais"). The registration in the ROF module must be supported by a loan agreement or a statement of the foreign creditor attesting to the terms and conditions.

Tax

The repayment of the principal amount of a foreign loan by a Brazilian company is not subject to the financial transactions tax (**IOF-Exchange**) nor to withholding income tax. There are other payments however on which IOF-Exchange or withholding income tax is payable.

IOF-Exchange

IOF-Exchange becomes due and payable on the closing of the foreign exchange transaction for the inflow of the funds into Brazil for the purposes of making the loan to the Brazilian company. The rate of the IOF-Exchange may be 0% or 6% on the closing of that foreign exchange transaction. The tax rate depends on the minimum average term of the loan

Currently, if the term is over 180 days, the IOF-Exchange rate will be 0%, however, if the term is less than 180 days the IOF-Exchange rate will be 6% 10

¹⁰ The levy of the IOF-Exchange will also depend on the legislation that was in force at the time the funds entered into Brazil. This is because, over the

Withholding tax

The payment of interest accrued on the loan, in its turn, is deemed to be income of the foreign lender and, therefore, is subject to withholding income tax at the rate of 15% or, if the beneficiaries are located in low tax jurisdictions, 25%. Lenders located in Japan might benefit from a lower tax rate (12.5%) under the Treaty to Avoid Double Taxation between Brazil and Japan.

Both the Brazilian company that has received the loan and the creditor company abroad may bear the cost of the withholding income tax. If the Brazilian company is responsible for the cost, the relevant amount should be grossed up to the interest amount, adjusting the tax basis of the withholding income tax accordingly. Preferential treatment is generally given to foreign government entities that have entered into treaties with Brazil.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Brazil, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

In general, the share control of a Brazilian publicly listed corporation is acquired through a private transaction, as companies participating in the capital markets usually have a high percentage of their voting shares out of the free float ¹¹. Despite the fact that a takeover through

years, the IOF regulations (Decree No. 6,306/2007) established different minimum average terms for cross-border loans that determined the applicability of the IOF-Exchange at the rate of 0% instead of 6%. Also, according to the legislation in force, if the interest rate of 0% is applicable to a cross-border loan transaction because of its minimum average term but the loan is liquidated earlier than the intended date (e.g., which was originally higher than 180 days), the legislation provides for the levy of the IOF-Exchange at 6% plus a late fine of 0.33% per day (limited to 20%) and late interest based on the SELIC rate (which is the standard reference rate).

11 The free float refers to the quantity of shares that are freely traded in the markets; that is, those shares issued by a corporation excluding those shares



a public offer is not common practice in Brazil, the Corporations Law allows the acquisition of the share control of a publicly held corporation through a public offer, if it is made to all holders of the voting shares. This is a voluntary proceeding, initiated by the interested investor, subject to registration with the Brazilian Securities and Exchange Commission (CVM).

The requirements for a public offer for acquisition of shares is governed by both the Corporations Law and by Rule 361, which was issued by the CVM on 5 March 2002, as amended (Rule 361). Rule 361 requires the party offering to acquire control of a given company to appoint a financial institution to intermediate the public offer. That financial institution must, among other obligations, guarantee the financial settlement of the offer. Therefore, in practice, the financial institution usually requires the offeror to deposit the amount equivalent to the acquisition price in advance of the offer. If the public offer is conditional on the granting of a loan, this condition needs to be stated in the public offer materials. The CVM also has discretionary powers to request information that may be relevant to the offer and to demand its disclosure in the public offer materials.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Under Article 83 of the Bankruptcy Law, the classification of debts in a bankruptcy will follow the following order of preference:

(a) amounts owing in relation to labor rights and payments to labor severance funds have priority over any other debts in the bankruptcy proceedings, limited to the amount equivalent to 150 minimum wages per employee (currently equivalent to BRL 101,700.00 – base-year 2013). Any amount in excess of the

that belong to the controlling shareholder(s) and those shares kept in the company's treasury.

- equivalent of 150 minimum wages will be treated as an unsecured debt owing to the employee;
- (b) secured creditors (i.e., those creditors secured by one or more *in rem* guarantees), up to the amount of the guarantee;
- (c) tax debts, regardless of their type and when they were incurred, except for tax penalties;
- (d) creditors with special privilege (as defined by law);
- (e) creditors with general privilege (as defined by law);
- (f) unsecured creditors (créditos quirografários);
- (g) contractual penalties and monetary penalties for breach of criminal or administrative laws, including tax penalties; and
- (h) subordinated debts, namely:
 - (i) those established in law or in contract; and
 - (ii) debts owing to partners/shareholders and administrators that are not employees.

Article 84 of the Bankruptcy Law sets out that certain debts will be treated as debts that are not subject to the concourse of creditors¹² in the bankruptcy and therefore must be paid before any payment to creditors listed in Article 83 is made. These debts are fees due to the judicial administrator and its assistants, loans or advances granted to the bankruptcy estate, and other fees and expenses related to the management of the bankruptcy estate.

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¹² The concourse of creditors is a civil law concept that refers to a group of creditors claiming the same assets. They "concur" to receive payment out of those assets.



8. Is interest on debt incurred to acquire a company in Brazil deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Interest on debt

Brazilian tax legislation provides for specific rules and conditions for deduction of expenses incurred by a Brazilian legal entity. Article 299 of the Income Tax Regulations (RIR/99) provides that the expense will be deductible if it is necessary for the activities of the company or for the maintenance of the relevant productive source, as well as usual or normal for the type of transactions, operations or activities of the relevant company.

Also Article 374 of RIR/99 provides that the interest paid or incurred but not yet paid by taxpayers is a deductible expense, as a cost or operational expense, within the limitations and requirements of the specific legislation. These rules are applicable in the accrual-basis accounting method. The Articles referred to above set out the general rules for the deduction of general expenses and interest expenses incurred by a legal entity. Based on these rules, the Brazilian company would have to demonstrate, by relevant evidence, that the expenses of the interest charged in relation to the debt was related to a normal, usual and necessary financing process for its activities.

Please also note that Article 26 of Law No. 12,249/10 provides for the non-deductibility of any costs or expenses (interest included) paid or credited by Brazilian sources to individuals or legal entities that reside or are domiciled in low-tax jurisdictions, or subject to privileged tax regimes, unless the following factors are established:

- (a) identification of the effective beneficiary of the payment abroad: and
- (b) the operational capacity of the non-resident individual or legal entity.

Thin capitalization thresholds

Thin capitalization rules were enacted by the Federal Government on December 15, 2009 by "Provisional Measure No. 472" which, among other changes, established limitations in relation to the deductibility of accrued interest due to foreign related parties and/or with lenders domiciled in low tax jurisdictions or subject to privileged tax regimes. This Provisional Measure was converted into the Law No. 12,249, dated June 11, 2010 (Law No. 12,249/10).

The limitations introduced by Law No. 12,249/10 relate to the payment of interest to foreign related parties. Under Law No. 12,249/10 the debt/equity ratio applicable for deductibility purposes is 2:1, excluding parties subject to a privileged tax regime or domiciled in low tax jurisdictions, in which case the applicable ratio is decreased to 0.3:1.

Finally, note that the thin capitalization ratios do not change based on the arm's length principle. Currently, interest paid or credited to related companies is only deductible up to the amount not exceeding the calculated value based on the interest rate defined by law¹³, increased by a spread based on the market average defined by the Minister of Finance ¹⁴.

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¹³ The following rates are the ones provided by the legislation: (a) in the case of transactions performed in US Dollars with a prefixed rate, the sovereign bonds of the Federal Republic of Brazil issued in the foreign market in US Dollars; (b) in the case of transactions performed abroad in Brazilian Reals with a prefixed rate, the sovereign bonds of the Federal Republic of Brazil issued in the foreign market in Brazilian Reals; and (c) for the remaining transactions, the London Interbank Offered Rate (LIBOR) during a six-month term.

¹⁴ For loan transactions in which the Brazilian company pays interest to a foreign-related party, a 3.5% spread applies. For loan transactions in which the Brazilian company accrues interest revenues, the spread is 2.5% as of 2 August 2013.



9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Brazil?

Contractual subordination is recognized by Article 83 of the Bankruptcy Law and it should therefore be recognized. Contractual subordination may not, however, modify the priority of creditors set out in the Bankruptcy Law.

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Canada

1. Is there any prohibition on a company incorporated in Canada providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

The provisions under Canadian law restricting financial assistance were repealed by the federal Canada Business Corporations Act (**CBCA**) and the Ontario Business Corporations Act (**BCA**). These provisions were repealed when various amendments to the CBCA and OBCA were made in 2001 and 2006 respectively.

Previously, the restrictions were found in section 44 of the CBCA and section 20 of the OBCA.

In the absence of the provisions restricting financial assistance under the CBCA and OBCA there are no restrictions that would prohibit a corporation from giving financial assistance by means of a loan, guarantee or otherwise:

- (a) to any shareholder, director, officer or employee of the corporation or of an affiliated corporation; or
- (b) to any associate of a shareholder, director, officer or employee of the corporation or of an affiliated corporation,

whether or not:

- (c) the corporation is, or after giving the financial assistance would be, unable to pay its liabilities as they become due; or
- (d) the realizable value of the corporation's assets, excluding the amount of any financial assistance in the form of a loan or in the form of assets pledged or encumbered to secure a guarantee, after giving the financial assistance, would be less than the aggregate of the corporation's liabilities and stated capital of all classes.



Despite the repeal of the provisions restricting financial assistance. directors involved in transactions involving the giving of financial assistance are subject to statutory fiduciary duties to act in the best interests of the corporation and can be sued for failing to do so. It is arguable that this provides adequate safeguards.

2. What are the implications under the corporate benefit laws of Canada for a company providing Financial Assistance?

Even though there are no explicit restrictions that would prohibit a corporation from giving financial assistance (as noted in the answer to question 1) the directors of the relevant corporation need to act in the best interests of the company. The effect of this is that financial assistance cannot be given unless it is in the best interests of the company.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Each Canadian province and territory has enacted personal property security legislation governing the taking of security over personal property.

Other than Québec's legislation, the relevant statutes within each province are referred to as the *Personal Property Security Act* (PPSA). These statutes are similar to, and are generally based on, Article 9 of the United States' "Uniform Commercial Code".

PPSA States

The PPSA in each of the states that has the PPSA (**PPSA States**) provides a comprehensive set of rules governing the rights of creditors and debtors when personal property is used as collateral to secure

payment of a debt or performance of an obligation. The legislation also provides for provincial computer-based registry systems for the perfection by registration of security interests in personal property such as equipment, inventory, accounts receivable and intangibles.

The types of transactions to which the PPSA normally applies include loans, chattel mortgages, conditional sales, assignments of book debts or accounts receivable, equipment leases, consignments by way of security and assignments of rents.

The most typical types of security taken in acquisition finance transactions over property in Canada include:

- (a) pledges of shares;
- (b) charges and security interests over all other property, assets and undertaking of a person (including intellectual property rights);
- (c) real property in the form of charges and mortgages against freehold estate and the leasehold estate.

Generally speaking, there are no formal or technical requirements for the grant of security by a person such as notarizations or government approval.

Quebec

Québec, being the only civil law jurisdiction in Canada, has included personal property security legislation in the *Civil Code of Québec* (Civil Code).

Like under the PPSA in the PPSA states, the Civil Code also provides a comprehensive set of rules governing the rights of creditors and debtors when personal property is used as collateral to secure payment of a debt or performance of an obligation. The legislation also provides for provincial computer-based registry systems for the



perfection by registration of security interests in personal property such as equipment, inventory, accounts receivable and intangibles.

In Québec, an instrument called a "hypothec" is used to charge movable (personal) property. A universal hypothec can be used to charge all of the debtor's personal property or a specific hypothec may be used to charge specific personal property of the debtor.

Quebec imposes certain formalities on the execution of certain types of security documents. The exceptions to the general rule include approvals and consents to share transfers that would occur as a result of any pledge of shares as well as the registration of security with the applicable government registry system for both personal and real property.

General

In addition, it is often the case that to the extent that any intellectual property rights such as trademarks or patents are included in the security grant, it is possible to register notice of those security interests with the Canadian Intellectual Property Office to give notice that those intellectual property rights have been pledged to a secured party. Further, if collateral includes rights in aircraft, ships, railway rolling stock and certain other classes of collateral, separate Canadian federal statutes may apply and govern the perfection, preservation and enforcement of those rights.

Canadian chartered banks may also take security over certain assets of their customers (for example, the inventory of a manufacturer) under the Bank Act (Canada) (S.C. 1991, c.46) (Bank Act). This type of security can be advantageous because, unlike security taken under the provincial personal property security statutes, security taken under the Bank Act is effective across Canada

Other than normal nominal filing fees relating to registration of personal and real property security, there are no stamp or other taxes payable in connection with the grant of security in Canada.

4. How long, following acquisition of a foreign target company, would it usually take in Canada for a Canadian subsidiary of that foreign target company to grant a guarantee/security?

There is no prerequisite period of time to which a company or its subsidiaries would be subject before being able to grant security.

The grant of security can be approved by the directors of a company, subject to any shareholder agreements or declarations in place that would prevent this. Therefore it is not uncommon for target companies and their subsidiaries to deliver security concurrently with the closing of an acquisition. This arrangement may be agreed to in advance among the parties so that the seller group is aware that security over the target group will have to be delivered concurrently with the finalizing of the acquisition. There may be some timing issues in Quebec however due to certain formalities that may have to be followed, but this would typically not delay the delivery of a guarantee/security for more than a few days.

5. Are there any restrictions on foreign banks lending to companies in Canada? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

In Canada, banks are federally regulated under the Bank Act, and carry on business under the supervisory authority of the Office of the Superintendent of Financial Institutions (**OSFI**). The Bank Act also covers foreign banks and their operations and investments in Canada, directly or through affiliates. Foreign banks and entities associated with a foreign bank are subject to the provisions of Part XII of the Bank Act. Sub-section 510(1) of the Bank Act states:

"Except as permitted by this Part, a foreign bank or an entity associated with a foreign bank shall not

(a) in Canada, engage in or carry on



- (i) any business that a bank is permitted to engage in or carry on under this Act, or
- (ii) any other business;
- (b) acquire or hold control of, or a substantial investment in, a Canadian entity."

Generally speaking there are no restrictions on residents of Canada (corporate or individual) engaging in offshore banking by opening and maintaining offshore bank accounts and taking out loans. However, in order to avoid any Canadian bank licensing and regulatory compliance issues, any offshore services provided by a foreign bank must be conducted outside Canada, with no agent or representative of the foreign bank having a business presence in Canada or travelling to Canada to carry on business. Any contracts between the foreign bank and Canadian borrowers must be negotiated and executed outside Canada. Any activity carried out by a nominee or agent of the foreign bank would be deemed to have been carried out by the foreign bank if the activity in question is banking business.

Foreign banks may set up and obtain regulatory authorization under the Bank Act for a subsidiary (a "Schedule II" bank under the Bank Act) or branch (a "Schedule III" authorized foreign bank branch) in order to carry on business and provide loans in Canada.

Withholding tax

Canada does not impose withholding tax on interest paid to foreign banks, if the bank deals at arm's length with the Canadian borrower and the interest is not "participating debt interest." In general terms, "participating debt interest" is interest which is contingent or dependent on the use or production from property in Canada or computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders.

Non-arm's length interest is subject to a 25 % withholding tax under the *Income Tax Act* (Canada), which is generally reduced to 10% for payments to persons resident in those countries with which Canada has entered into a tax treaty. The recent protocol to the U.S. tax treaty with Canada has reduced the withholding tax on non-arm's length interest payments (other than interest similar to "participating debt interest") to nil.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Canada, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Generally speaking provincial securities regulation provides that the financing arrangements required to be made for a take-over bid may be subject to conditions if, at the time the bid is commenced, the offeror reasonably believes the possibility to be remote that, if the conditions of the bid are satisfied or waived, the offeror will be unable to pay for the securities deposited under the bid due to a financing condition not being satisfied.

Subsequently, although takeover bids and tender offers are allowed to be conditional in Canada, financing conditions are not permitted. Potential acquirers bidding for Canadian target companies must make adequate financing arrangements before making a bid. This does not mean that the financing must be unconditional, but the bidder must "reasonably believe the possibility to be remote" that it will not be able to pay for the securities. The types of conditions acceptable in this regard are a matter of judgment that is usually discussed with advisers

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

In Canada, the insolvent liquidation or bankruptcy of an individual, partnership, estate or corporation is dealt with under the *Bankruptcy*



and Insolvency Act (BIA). In simple terms, a trustee in bankruptcy is appointed over all of the assets of the bankrupt person. The assets are sold and the proceeds are distributed on an equitable basis to creditors of the bankrupt. The order of priority is set out in s.136 of the BIA, which provides in general terms, the ordering of claims as follows:

- (a) secured creditors;
- (b) preferred creditors; and
- (c) ordinary unsecured creditors.

Equity holders in Canada rank behind ordinary unsecured creditors. This means that all debt holders must be paid before any of the bankrupt's assets become available to equity holders.

Secured creditors

A secured creditor is a person holding a mortgage, pledge, charge (including a charge under a court order), lien or privilege over the property of the debtor as security for a debt due or outstanding but not yet due and payable. The property constituting the collateral can be personal or real property.

Secured creditors in an insolvent liquidation enjoy a priority over everyone else, subject to certain exceptions.

The main exceptions include:

- (a) priorities for employee wage withholdings deducted but not paid to the government for income taxes, Canada pension plan and employment insurance;
- (b) certain priorities for suppliers of goods that fall within certain protected groups of suppliers; and
- (c) certain claims relating to unpaid wages and pension arrears.

In a bankruptcy, the failure to properly protect a non-possessory security interest will result in the trustee-in-bankruptcy taking the secured asset free of the security. The unregistered secured creditor is then treated as an unsecured creditor.

Real property security agreements such as a mortgage are dealt with under the normal land registration statutes.

Depending on the type of security agreement and its wording, secured creditors may enforce their security in a variety of ways, including the repossession or disabling of secured property. Security agreements frequently provide for the appointment of a private receiver (usually an insolvency practitioner with an accounting firm) on default under the agreement. Alternatively, the court may be asked to appoint a receiver over the property in question. In either case, the receiver then has the duty and obligation to collect and realize the property that is the subject of the appointment. The BIA additionally imposes duties of honesty and good faith on privately appointed receivers and requires the secured creditor and receiver to act in a commercially reasonable manner. A court-appointed receiver will have a fiduciary duty to all stakeholders, not just to the secured creditors.

Preferred creditors

The BIA provides for certain "preferred creditors" whose claims are granted priority over the unsecured creditors of the bankrupt. For example, the claims of funeral expenses, municipal taxes and landlord arrears for the previous three months and accelerated rent of not more than three months after the date of bankruptcy are preferred claims that are paid in full before unsecured creditors.

Ordinary unsecured creditors

Ordinary unsecured creditors include all suppliers of goods and services that do not enjoy any security or special priority as a secured or preferred creditor.



8. Is interest on debt incurred to acquire a company in Canada deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Interest

Interest on debt incurred to acquire a company in Canada is generally deductible from earnings for tax purposes. If the Canadian purchaser is a holding company that has no earnings, the practice is to amalgamate it with the Canadian target after the acquisition of the target to deduct the interest from earnings of the target.

Thin capitalization thresholds

No thin capitalization thresholds would generally apply.

However, under proposed rules that will become effective in 2015, if there is a "back-to-back loan" arrangement under which the bank lends funds to the Canadian entity and a non-Canadian entity not dealing at arm's length with the Canadian entity provides security for the loan to the bank, or lends funds to the bank on a limited recourse basis or on condition that a loan be made to the Canadian entity, that arrangement will be treated as including a loan that is subject to the thin capitalization rules to the extent of the credit support provided by the non-resident.

Notably, foreign parent guarantees of the debts of a Canadian entity will now come within the ambit of the thin capitalization rules where the guarantee is secured. Unsecured guarantees are unaffected. Canada's thin capitalization debt equity ratio is 1.5:1. Equity includes share capital, contributed surplus and retained earnings of the Canadian entity.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Canada?

In Canada, creditors, both secured and unsecured, are able, in law, to order priorities amongst themselves through enforceable contracts.

These contractual priorities and/or subordination agreements will, generally speaking, be honored by liquidators or bankruptcy trustees, if the re-ordering of priority does not create a problem for trustees *visà-vis* other creditors of the bankrupt. The trustees and liquidators however are not bound, *per se*, by the terms of the agreements.

For example, a common provision in a priorities or subordination agreement states that the parties to the agreement will not challenge, or assist in challenging, the security, if any, or the priority of the respective claims. Trustees or liquidators are not bound by the provisions and are free to review the claims and security. This may lead to two main risks for creditors that are parties to these agreements:

- (a) the risk that the trustee will identify a circular priority problem created by the agreement; and
- (b) more importantly, that the trustee disallows a claim or disputes the security of the beneficiary of the subordination.

In relation to (a) above, a subordination agreement that creates a circular priority with a third creditor may not be enforceable or the enforcement of it may lead to an unintended result for the parties to the agreement. In relation to (b) above, a subordination agreement between two secured creditors, where the security of the beneficiary of the subordination is found by the trustee or liquidator to be invalid, may lead to the unintended result of the subordinating secured creditor losing its secured status.

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Chile

1. Is there any prohibition on a company incorporated in Chile providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

In Chile, the concept of financial assistance has not been developed yet and the giving of financial assistance is generally permitted. For instance, Chilean laws do not contain any financial assistance rules restricting the granting of security. A company incorporated in Chile may grant any security as long as the corresponding corporate authorizations and powers of attorney have been duly granted.

Nevertheless, we believe that some provisions of Act No. 18,046 (Corporations Act) would implicitly regulate financial assistance. For example, Article 42, No. 1 of the Corporations Act expressly prohibits directors of Chilean corporations from proposing amendments to their bylaws, approving the issue of securities, adopting policies or making decisions that are not in the corporation's interest (but are in the interests of related third parties).

2. What are the implications under the corporate benefit laws of Chile for a company providing financial assistance?

Generally speaking, since the concept of financial assistance has not been developed yet, there are no direct implications under Chilean law for a company providing financial assistance.

Nevertheless, as the concept of financial assistance is arguably implicitly regulated under the current general rules of Chilean corporate law, there may be some implications for corporations giving financial assistance

As mentioned in the answer to question 1, directors of Chilean corporations are prevented from making any decisions that are not in the corporation's interest (e.g., the issue of securities).

In the event of a breach, a director will be personally liable (i.e., with their personal funds) and jointly and severally liable for the whole amount of any damage caused by the breach.

Also, under Article 45 of the Corporations Act, directors are presumed to be responsible and bear the burden of proof if:

- (a) the share issue or financial assistance is against the corporation's interest; and
- (b) the directors receive a benefit in an improper manner from that financial assistance (whether directly or through another individual or legal entity).

Also, the granting of a personal guarantee or a real guarantee (which requires delivery of the pledged guarantee to the creditor) to secure third party obligations for an amount exceeding 50% of a Chilean corporation's assets must be approved by two-thirds of the corporation's shareholders attending a special shareholders' meeting. If however a guarantee is granted to secure the obligations of a subsidiary or affiliate company, the approval of the board of directors is sufficient.

In both cases, dissenting shareholders have the right to withdraw from the corporation and the corporation must pay those shareholders the value of their shares (i.e., book value in the case of closely held corporations and market value of the shares in the case of publicly held corporations, determined in the manner specified in the regulations).



3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

In Chile, the main types of security interests are as set out below.

Mortgage

A mortgage creates a security interest over real estate that is owned by the mortgagor. Possession of the real estate does not pass to the creditor (mortgagee). The mortgage grants the mortgagee the right to pursue the real estate from whomever is in possession of it and to recover the amount owed, preferably from the proceeds obtained at an auction. A mortgage covers not only the property itself, but also the accessories, fixtures and improvements on and to the mortgaged property, rental income, indemnities payable by insurers and proceeds from expropriation. To be enforceable, a real estate mortgage must be executed by public instrument and registered in the Real Property Mortgage and Liens Register of the competent Real Estate Registrar.

Pledge

Pledges are governed by the Civil Code and the Commercial Code. Regardless of its civil or commercial nature, a pledge is a contract by which the pledgor gives personal property to the creditor (pledgee) to secure a right. If the pledgor defaults on his/her obligation, the contract grants the creditor the right to sell the property to recover the amount owed, preferably from proceeds obtained at an auction. The obligations that are secured must be specific. A pledge may secure not only an interest in personal property, excluding vessels and aircraft, but also in loans and currency. In the case of loans and currency, the pledgee/creditor becomes the legal owner of the money and, on fulfillment of the obligation secured, must return to the pledgor any surplus amount after satisfaction of the secured obligation.

The civil pledge is a security agreement that is perfected by delivering the pledged item to the creditor. However, for evidentiary purposes, the security interest must be established in writing. Security interests in relation to negotiable securities are formalized by delivering the relevant certificate, unless otherwise agreed on (i.e., deposit). In the case of nominative loans (which are loans that are not endorsable), and to create rights against third parties, in addition to the delivery of the certificate, it is also necessary to notify the debtor or obtain the debtor's approval. Security interests in relation to a bearer loans are formalized by endorsement (normally including the phrase "valor en garantía").

Commercial pledges are perfected in the same way as civil pledges. However, to grant the creditor recovery privileges over other creditors in relation to a commercial pledge, it is necessary to:

- (a) execute the security agreement by public instrument or by private instrument duly certified by a notary public and registered in the relevant notarial register; and
- (b) include in the public or private instrument the amount of the debt and a description of the security interest, or to attach to it a description of the quality, weight or size of the same.

Pledge without conveyance under Act No. 20,190 (Act No. 20, 190)

Currently, there is a single unified pledge without conveyance (**Pledge without Conveyance**) and a national registry of pledges without conveyance. A Pledge without Conveyance creates an interest in personal property which guarantees the pledgor's own or a third party's obligations. It guarantees the loan together with accrued interest, expenses and costs, if any. Act No. 20,190 expressly recognizes the validity of the general floating pledge, which may include any undetermined future obligation.

Any movable property, whether tangible or intangible, can be pledged under a Pledge without Conveyance. The pledged property, however,



remains in the pledgor's possession and can therefore continue to be used by the pledgor. Pledges without Conveyance must be executed by either public instrument or private instrument, be duly certified by a notary public and registered in the relevant notarial register. An excerpt of the Pledge without Conveyance must be registered in the Pledge without Conveyance Registry within three working days. If the pledge over goods is subject to special registration formalities, the pledge must also be registered in the relevant registry. In the case of nominative loans, in addition to the above-mentioned requirements, it is also necessary to notify the relevant debtor or obtain his or her approval.

Pledge on securities in favor of banks

A pledge on securities in favor of banks creates an interest in bearer securities, negotiable loans or nominative shares from corporations to guarantee to a bank the fulfillment of obligations arising out of operations or agreements entered into or to be entered into in the future. This type of pledge guarantees any direct or indirect obligation of any nature assumed or to be assumed with the same bank by the pledgor, unless it expressly states that the pledge has been provided in relation to a specific obligation. Pledges on securities in favor of banks are subject to various formalities depending on the type of security interests that are secured. Pledges of bearer securities are perfected by delivery of the instruments, unless otherwise stated. Negotiable loans are perfected by endorsement. Security interests on nominative shares are perfected by public or private instrument and also require official notification to the relevant corporation.

Pledge of Warrants

A security interest on warrants serves to secure specific obligations in relation to pledged goods stored in general warehouses. No general security interest or second pledge over the same goods is permitted. Security interests over warrants are formalized by endorsing a document called a "pledge voucher," which must be recorded in the registry of the relevant warehouseman. The endorsement must state the name and domicile of the endorser, the principal loan amount and

interest, the date of the endorsement, as well as the loan due date and modalities, and must be signed by the endorser.

Notarial and registration fees are generally calculated as a percentage of the amount of the secured credit or asset with a cap. For instance, in the case of the registration of a real estate mortgage in the Real Estate Registrar of Santiago, the registration fees are calculated as a percentage of the value of the real estate up to a cap of approximately USD450 as of January 2015.

4. How long, following the acquisition of a foreign target company, would it usually take in Chile for a Chilean subsidiary of that foreign target company to grant a guarantee/security?

Granting a mortgage or a Pledge without Conveyance may take up to three weeks depending on factors such as the relevant registry, the city or place of execution of the document or the location of the assets.

Civil and commercial pledges however become effective on the date of the execution of the relevant public or private instrument, or the date of the endorsement, as applicable, and the delivery of the pledged asset(s) or the relevant certificate to the creditor. In the case of nominative loans, it is also necessary to notify the debtor or obtain his or her approval. For pledges on securities in favor of banks and pledges of warrants it is necessary to notify the debtor.

5. Are there any restrictions on foreign banks lending to companies in Chile? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

As a general rule, foreign banks may provide financing to companies in Chile. Chilean laws however prohibit a foreign bank not licensed in Chile from receiving funds from a Chilean customer or presenting itself in public as a bank or financial institution in Chile.



Under Articles 39 and 40 of Decree with Force of Law No. 3 (Banking Act), only banking institutions duly authorized by the Banks and Financial Institutions Superintendence (SBIF) may engage in the business of "receiving in a customary manner money or funds from the general public, in order to use it to grant loans, discount documents, make investments and effect financial intermediation, [or] obtain a rent out of this money."

Also, the Banking Act provides that no person, either an individual or legal entity, which has not been authorized by law, may:

- (a) engage by itself or on behalf of others, in the brokerage of money or loans represented by securities, commercial papers or any other credit title;
- (b) advertise banking services through the press or any other means of publicity;
- (c) display in its store or office signs or advertisements indicating that it is a banking company; or
- (d) use stamps, signs, certificates, forms, receipts, circular letters or any other writing containing names or other words indicating that the activities of such person are those of banking or financial intermediation

This means that no person, either an individual or legal entity, which has not been duly licensed/authorized, may present itself in public as a bank or financial institution.

It is presumed that an individual or legal entity has infringed these prohibitions if it has a store or an office in which, in any manner, the public is invited to bring money in any way or to which advertising is made by any means for the same purpose.

Infractions of these prohibitions are considered a criminal offense and may be punished with up to five years of imprisonment. Also, if as a

result of the wrongful activities the public suffers a loss of any nature, those responsible will be punished as perpetrators of fraud.

However, it is possible for foreign banks to perform promotional and marketing activities through representative offices in Chile. In fact, under Article 33 of the Banking Act, the SBIF may authorize a foreign bank to maintain a representative office acting as a business agent for its main office, and the SBIF will have the same inspection rights in relation to the representative office as it has under the Banking Act in relation to banks. These representative offices have no right to perform any acts that pertain to banking business under any circumstances. The authorization may be revoked at any time if the representative office does not comply with the Banking Act or if its maintenance is considered inconvenient.

Withholding tax

Interest paid to foreign entities is subject to a withholding tax of 35%. However, as a general rule, interest on loans granted abroad by a foreign or international bank or a financial institution is subject to tax at a reduced rate of 4%. To this effect, a voluntary registration is available by which the institution or bank may prove beforehand that it meets the criteria to qualify as a foreign financial institution. Note, however, that registration is not a requisite to benefit from the reduced withholding tax rate.

6. If a takeover bid that relies on bank debt is made for a publicly listed company in Chile, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

According to the rules contained in Chapter XXV of Act No. 18,045 regarding the Securities Market (the **Securities Market Act**), in the case of a takeover bid for a publicly listed company or public offering for the acquisition of shares, the bidder must publish a notice informing the market of the commencement of the public tender offer. From the date the notice is published until the payment of



shareholders, the bidder must provide interested parties with a prospectus that states:

"the manner in which the bidder shall finance the payment of the price of the shares that are acquired at the end of the bid."

If there are loans or capital contributions involved, the bidder must also provide:

"the information necessary to conclude that there are actually funds to pay the price."

Bidders may also choose to establish a guarantee for an amount which may not be less than 10% of the total amount of the takeover bid and may be provided with a bank certificate confirming the guarantee or an acknowledgement by the bank confirming a time deposit (*Deposito* a Plazo) taken with a local bank or financial institution, pledge over publicly offered securities, or insurance policy, which will remain in custody in a bank or stock exchange. The guarantee must be provided to the Chilean Securities Superintendence (Superintendencia de Valores y Seguros) and include as a minimum an indemnity for loss in the event of non-fulfillment of the obligation to pay the price to all those affected for any reason.

Also, this guarantee must be effective for a period of 30 days following the publication referred to in Article 212 of the Securities Market Act (which must be made the third day after the expiration of the effective date of the offer or an extension of the offer) or until the expiry of the term established for payment, whichever is later.

Any dispute related to the fulfillment of the offer between the bidder and the accepting shareholders will be subject to arbitration and the arbitrator will proceed and decide as amiable compositeur or ex aequo et bono.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

While the general principle is that in the event of the insolvency of a debtor, the proceeds of the sale of the debtor's assets are to be distributed among all creditors *pro rata* in relation to the debts owing to them, Chilean legislation establishes some privileges in relation to the payment of capital, interest and fines.

Some preferences are general (the preference applies over the whole estate) and others are specific (the preference only applies over certain assets given as security). General preferences mostly relate to particular liabilities of the debtor, such as labor and tax. Specific preferences relate mostly to credits secured with mortgages and pledges over specific assets of the debtor.

The order of preference of creditors' claims is as follows:

- (a) first-class privileged debts which include:
 - (i) any judicial costs incurred by creditors;
 - (ii) funeral costs of the deceased debtor;
 - (iii) the debtor's medical expenses;
 - (iv) expenses incurred in disposing of the deceased debtor's assets;
 - (v) bankruptcy administration and asset disposal costs;
 - (vi) employees' remunerations, family allowances and payroll taxes;
 - (vii) sustenance items delivered to the debtor and the debtor's family during the last three months;



- (viii) limited legal and contractual accrued severance payments; and
- fiscal tax credits arising from withholding taxes and surcharges;
- (b) second-class privileged debts which include pledges and some arrangements where the creditor is entitled to hold and retain the security interest;
- (c) third-class privileged debts which include real estate mortgages;
- (d) fourth-class privileged debts which include mainly obligations to the administrators of third parties' assets; and
- (e) fifth-class debts which include non-privileged debts that are repaid proportionately from the balance of the debtor's assets after repayment of any privileged or preferred credits.

Rights of repayment of first-class privileged debts apply to all of the debtor's assets and prevail over any other privileged or non-privileged debts.

Mortgagees and pledgees have preference over other creditors and are entitled to recover their loans from the value of the security, but are entitled to first-class priority if the loans have not been satisfied from the proceeds of the debtor's other assets. Also, pledgees and mortgagees are entitled to recovery against the secured property only, and not against the debtor's other assets. Consequently, if part of the loan remains unpaid after the disposal of the pledged property, the unpaid balance of the debt will be considered to be a fifth-class debt. When several mortgages have been granted over the same real estate, the preference will depend on the registration date of each of the mortgages. If other security interests have been granted with the mortgagee's consent, the priority will also depend on the date of the relevant registration. In the case of security interests over warrants, the creditor is entitled to recovery on payment of any taxes due by virtue

of the warehousing agreement and auction expenses, and payment of the corresponding warehouseman fees. The preference regulations for pledge without conveyance are the same as those indicated for common pledges.

Chilean law does not distinguish between debt holders and equity holders. Therefore, both will be deemed to be fifth-class, non-privileged creditors, unless their debts have been secured with a pledge or a mortgage.

8. Is interest on debt incurred to acquire a company in Chile deductible from earning for tax purposes? Are there any thin capitalization thresholds?

According to Article 31 of the Chilean Income Tax Law, expenses related to interest paid or accrued on amounts due are deductible, if they are well-documented and proven, and they relate to the line of business of the taxpayer, plus adhere to other general deductibility requisites.

Chile has no thin capitalization threshold that limits the deductibility of interest

There is a thin capitalization rule relating to the reduced 4% withholding tax for interest payments to foreign financial institutions, but only relating to excess indebtedness obtained from related parties and/or back-to-back loans. The thin capitalization is set at a debt to equity ratio of 3:1. The interest paid on the qualifying excess of indebtedness will be subject to an additional 31% tax rate to be borne by the debtor.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Chile?

Contractual subordination of debts owing to fifth-class creditors is expressly permitted by Article 2489 of the Chilean Civil Code, which defines credit subordination as:



"an act or contract under which one or more fifth-class creditors agree to postpone, in full or part, the payment of their [debts] in favor of one or more [debts] of the same class, whether present or future."

Subordination agreements must be executed by means of a public instrument or a private instrument duly certified by a notary public and registered in the relevant notary public's register.

Credit subordination can also be established unilaterally by the debtor at the moment of issue of the debt, in which case the subordination will be irrevocable.

Subordination will include both capital and interests, unless otherwise indicated. The debtor must honor the subordination agreement if it has signed or accepted the subordination agreement or the debtor has been duly notified of the credit subordination.

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China

1. Is there any prohibition on a company incorporated in China providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

The concept of financial assistance under the law of the People's Republic of China (PRC) only applies to listed companies. Except in the context of listed companies, there is no particular prohibition on a PRC company providing security or other forms of financial assistance in connection with an acquisition of equity interests in that PRC company or its direct or indirect holding company.

However, Article 16 of the Company Law of the PRC (effective 1 January 2006) (PRC Company Law) contains a general restriction on PRC companies providing third party guarantees or security whether or not the secured indebtedness is for the purpose of an acquisition. Where a PRC company provides a guarantee or security to guarantee or secure the liabilities of its shareholder(s) or a person who actually controls the PRC company, the provision of the guarantee or security must be approved by the shareholders. Approval has to be given by a shareholders' resolution passed by more than half of the shareholders present at the meeting and entitled to vote. The shareholder whose debts are being secured by the company and any shareholder controlled by the *de facto* controller are not entitled to vote.

In relation to listed companies, under Article 8 of the Takeover Rules of Listed Companies (effective 1 September 2006 and last modified on 14 February 2012) (**Takeover Rules**), the board of directors of a listed PRC company is prohibited from approving the provision of any form of financial assistance involving the use of the resources of the PRC company that is the subject of the proposed takeover. Moreover, companies limited by shares that are seeking to be listed offshore are required under the Mandatory Provisions to be Adopted in the Articles of Association of Companies Seeking Offshore Listing to include in their constitutional documents restrictions on themselves and their



subsidiaries from providing any form of financial assistance to their acquirers. Accordingly, offshore-listed PRC companies and their subsidiaries will not be able to provide any financial assistance in connection with the acquisition of shares in those companies or their parent companies due to those restrictions in their constitutional documents.

If the beneficiary of a guarantee/security is a party located outside China, the restrictions relating to foreign security will also apply. Details of these restrictions are explained in the answer to question 3 below

2. What are the implications under the corporate benefit laws of China for a company providing financial assistance?

The laws of the PRC do not apply a "corporate benefit" or "commercial benefit" test to a PRC company in relation to whether or not a transaction should be entered into by a PRC company.

However, PRC Company Law imposes a general duty of diligence and a general duty of loyalty on the directors, supervisors and senior managers of a PRC company. They should not, by taking advantage of their functions and powers, accept bribes or other unlawful income nor misappropriate the property of the company. The duties are similar to fiduciary duties under common law, but the exact scope of these duties is not clearly described in the PRC Company Law.

If the directors, supervisors or senior managers of a PRC company abuse their powers or rights, and this results in losses to their company, those officers will be required to indemnify the company for all losses incurred by the firm. For instance, if a director of a PRC company has certain specific interests in another group to which security will be provided by the PRC company, and he/she votes in favor of the provision of security by that PRC company at the board meeting for the benefit of his/her own interests, and subsequently the PRC company suffers a loss arising from its provision of security, the director may be liable for that loss. However, the law does not clearly stipulate what constitutes an act of abuse and how to quantify the loss suffered by the PRC company. This would, therefore, be determined in the PRC court's sole discretion.

When considering providing financial assistance in relation to the acquisition of a PRC company's equity interests or equity interests in its holding company, the directors of the PRC company must:

- (a) check and ensure that they are not an interested party in relation to that financial assistance; and
- (b) if the guarantee/security is granted to guarantee or secure the debts of the company's shareholders, ensure that shareholders' approval is obtained in accordance with Article 16 of the PRC Company Law (see the answer to question 1 above).
- 3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and, if so, what is the basis for calculation?

Types of security

The most typical types of security that can be granted over property in China include:

- (a) a mortgage over real property (land use rights, buildings and buildings under construction);
- (b) a mortgage over equipment;
- (c) a pledge over equity interests in a company (equity pledge);
- (d) a floating mortgage over present and future raw materials and semi-finished or finished products; and



(e) a pledge over receivables.

Legal concerns relating to granting upstream foreign security in a global LBO context

In the context of a global leveraged buy-out (**LBO**) under which the acquirer (borrower) is located outside China and the target group including subsidiaries is incorporated in China, those PRC subsidiaries are foreign-invested enterprises (**FIEs**). This includes PRC companies with participation of foreign investors, which are either:

- (a) wholly foreign-owned enterprises (**WFOEs**), i.e., 100% owned by foreign investors; or
- (b) Sino-foreign joint venture companies, i.e., owned by foreign investors and Chinese parties jointly.

According to the Notice Regarding the Administration of Foreign Security provided by Domestic Institutions (Huifa No. [2010] 39) promulgated by SAFE on 30 July 2010 (SAFE Foreign Security Notice), the provision by an FIE of security or a guarantee (Foreign Security) in favor of a party located outside China is generally subject to the approval of SAFE on a case-by-case basis unless:

- (a) the foreign security is provided by the FIE to secure its own obligations; ¹⁵ or
- (b) the FIE has obtained from SAFE an annual quota¹⁶ for Foreign Security permitted to be provided by it within a year, and grants the relevant Foreign Security within that quota.

¹⁵ In a global LBO, this is usually not the case, as the borrower is always the offshore acquirer or offshore target holding company unless the LBO also provides for working capital facilities to local target subsidiaries. In that case, the PRC target subsidiaries will be able to grant Foreign Security for their

the PRC target subsidiaries will be able to grant Foreign Security for their own obligations for that working capital facility available to them.

Whether or not any approval is necessary, the security provider will need to register the Foreign Security with the local branch of SAFE within 15 days after execution of the relevant security document.

Under the SAFE Foreign Security Notice, in order for Foreign Security to be granted to secure the debt of a foreign party under the quota system, the party whose debt is secured by the relevant Foreign Security is required to be an entity in which the Chinese security provider holds direct or indirect equity interests.

Taking the above into account in the context of a global LBO, PRC subsidiaries (whether WFOEs or other FIEs) are unable to give Foreign Security to secure the acquisition facility of their offshore acquirer or offshore target holding company. Usually, the only PRC security that the LBO lenders may obtain is an equity pledge granted by the offshore direct shareholder of the PRC subsidiary over its equity interests in that PRC subsidiary. Note that only the paid-up portion of the capital contribution of that offshore shareholder may be pledged.

Perfection of equity pledge

An equity pledge over equity interests in an FIE must be:

(a) approved by the original approval and examination authority in relation to the initial establishment of that FIE, which is usually the local branch of the Ministry of Commerce or its other authorized local authority (Original Approval Authority);

¹⁶ Although the SAFE Foreign Security Notice allows FIEs to apply to SAFE for an annual quota for Foreign Security to be provided by it, subject to the satisfaction of certain financial criteria, our experience shows that, in practice, it is rare for an enterprise other than a state-owned enterprise to obtain a quota. Current PRC regulations provide for a separate regulatory regime for Foreign Security granted by PRC banks or non-banking financial institutions, but details of that regime are beyond the scope of this publication.



- (b) filed with the local bureau of the State Administration of Industry and Commerce within 30 days of obtaining the approval referred to in paragraph (a) above; and
- (c) recorded in the FIE's register of shareholders.

There is no statutory time frame for the equity pledge to be submitted to the Original Approval Authority. However, it is in the interests of all parties concerned to obtain approval and proceed with filing as soon as possible, since an unapproved and unfiled equity pledge is invalid under Article 12 of Changes of Equity Interest of Investors in FIE Several Provisions (effective 28 May 1997). The Original Approval Authority must decide whether or not to grant an approval within 30 days of the submission of the relevant documents. The FIE is responsible for obtaining that approval and the filing process.

In practice, obtaining approval from the Original Approval Authority is generally a procedural matter, although the time frame varies from one city to another. The approval process could be a few days or a few months depending on the effectiveness of communication between the relevant FIE and its Original Approval Authority.

Tax/Duty

No stamp duty or tax will be payable on the execution or enforcement of the security discussed above, except that:

- (a) when mortgaged real property/equipment or other assets or pledged shares/equity or other assets are transferred as a result of the enforcement, stamp duty will be imposed on the parties (buyer and seller) at a rate of 0.05% of the purchase price of the assets as stipulated in the relevant contracts; and
- (b) deed tax will be imposed on the buyer when mortgaged real property is transferred as a result of the enforcement at a rate of 3% to 5% (depending on the location of the real property) of the purchase price of the transferred real property.

In addition, registration fees and/or notarization fees will be charged by registration authorities and/or notarization offices, subject to local requirements.

4. How long, following acquisition of a foreign target company, would it usually take in China for a Chinese subsidiary of that foreign target company to grant a guarantee/ security?

The timeline usually depends on the complexity of the financing and security structure and may also vary for different types of security and their localities. Generally, after execution of the transaction documents, four to six weeks is reasonable for collecting all supporting documents and submitting them to the authorities for registration. If governmental approval is required for the security, the whole procedure may take two to three months to complete.

5. Are there any restrictions on foreign banks lending to companies in China? Are interest payments to foreign banks typically subject to withholding tax?

Foreign debt

Until recently, foreign banks, being entities located outside China, typically made foreign currency loans to companies incorporated in China. As a result of the PRC government's decision to globalize Renminbi, the local currency of China (RMB), new regulations have been issued to allow foreign banks to make RMB loans (RMB Foreign Debts) to FIEs (other than FIEs engaged in real estate development). All loans, irrespective of the currency denomination, from offshore lenders are classified as foreign debts under PRC law.

RMB is not freely convertible to other currencies.

Under the current foreign exchange control regime in China, payment and receipt of foreign exchange are divided into two categories:



- (a) "capital account items" for capital and debt-related funds flows, such as direct investment and foreign exchange loans from foreign entities: and
- (b) "current account items" for trade and service-related funds flows.

Cross-border fund flow of capital account items is closely monitored by SAFE. In most cases, SAFE approval and/or registration is required.

A foreign currency loan granted by a foreign bank located outside China to a PRC company will be categorized as a foreign currency foreign debt of that PRC company. Therefore, the PRC borrower must:

- (a) effect foreign debt registration with the local branch of SAFE within 15 working days after entering into the loan agreement. If the loan agreement is not prepared in the Chinese language, a Chinese language summary of the major terms of the loan facility must be submitted to the local branch of SAFE for registration purposes; and
- (b) open a designated foreign debt account with a bank in China for receiving loan proceeds and making payments under the loan.

Without foreign debt registration, the PRC borrower will not be able to draw down or repay the loan or pay any interest or fees to the offshore lender

In addition to the SAFE registration requirements outlined above, if the borrower of foreign debt is:

(a) not an FIE but a domestic enterprise that has no borrowing gap (as defined in the following pages); or

(b) an FIE with less than 25% foreign participation ¹⁷,

prior approval from the local branch of SAFE must be obtained.¹⁸ If the tenor of the loan to be borrowed is more than one year, the wholly Chinese-owned enterprise must also obtain approval from the National Development and Reform Commission (**NDRC**) as well as approval from its local SAFE.

In our experience, it is generally not easy for a domestic enterprise to satisfy the SAFE requirements for approval outlined in footnote 15, and obtain those approvals from its local SAFE and the NDRC. As a general observation, only large state-owned enterprises have been granted approvals for borrowing foreign debt.

In connection with RMB foreign debt, the PRC borrower is generally required to comply with the foreign debt registration regime applicable to foreign currency loans as outlined above, including:

¹⁷ For the purposes of discussion in the remaining parts of our reply to this question 5, FIE means an FIE with at least 25% foreign participation.

Article 7 of the Administration of Taking Out of International Commercial Loans (ICLs) by Organisations in China Procedures (promulgated 24 September 1997) provides that non-financial enterprises taking out foreign debts shall meet the following requirements:

⁽i) they have produced profits for the past three consecutive years, have been granted permission for import and export business, and are in a line of business that is encouraged by the State;

⁽ii) they have a sound financial management system;

⁽iii) for trade-oriented non-financial enterprises, the ratio between net assets and total assets shall not be lower than 15%;

⁽iv) for non-trade-oriented non-financial enterprises, the ratio between net assets and total assets shall not be lower than 30%;

⁽v) the sum of foreign debts taken out and the balance of guarantees provided to foreign entities shall not exceed 50% of its net asset value equivalent in foreign exchange; and

⁽vi) the sum of foreign debts and the balance of guarantees/security in foreign exchange shall not exceed the amount of foreign exchange it generated in the previous year.



- (a) filing that RMB foreign debt with the local office of the People's Bank of China and the local branch of SAFE; and
- (b) opening an RMB settlement account for the drawdown, repayment and interest payment in relation to that RMB foreign debt.

Borrowing gap

The aggregate principal amount of the foreign debts of an FIE must not exceed its borrowing gap (as defined below) (see Article 18 of Foreign Debts Administration Procedures, Section 3 of the SAFE Notice on Improving the Examination of Foreign Exchange Settlement for Capital Items and Registration of Foreign Debt of Foreign-Invested Enterprises (effective 1 July 2004) and Article 12 of Notice on Clarifying the Operational Rules for RMB Accounts Settlement for Foreign Direct Investment (effective 14 June 2012) (PBOC Notice)).

The borrowing gap is the difference between an FIE's total investment and registered capital. It represents the maximum amount that an FIE is permitted to borrow from third parties (including its shareholders) to finance its operations. SAFE will not register a foreign debt loan agreement entered into by an FIE if the amount of the loan facility exceeds the amount of its unutilized borrowing gap.

The borrowing gap of an FIE may be restored each time its short-term foreign currency foreign debt (being foreign currency foreign debts with a tenor of no more than one year) is repaid. However, it will be permanently used up by the FIE's incurrence of mid-term and longterm foreign currency foreign debts (being foreign currency foreign debts with a tenor of more than one year) or RMB foreign debt. It will not be reinstated by any repayment of those mid-term and long-term foreign debts or RMB foreign debt.

If the principal amount of the foreign debt to be borrowed by an FIE will exceed its borrowing gap, that FIE may increase its total investment so as to increase it. However, as a general rule, the FIE's registered capital must also be increased proportionally because of the proportion requirement on its total investment and registered capital. The chart below shows the proportion requirement on an FIE's total investment and registered capital:

Total investment	Minimum registered capital (% of total investment)
USD3 million or less	70%
USD3 million (exclusive) to USD10 million (inclusive)	50% or USD2.1 million (whichever is higher)
USD10 million (exclusive) to USD30 million (inclusive)	40% or USD5 million (whichever is higher)
More than USD30 million	33.3% or USD12 million (whichever is higher)

The Ministry of Commerce and the State Administration of Industry and Commerce must approve any exception to the proportion requirement in the table above.

In addition, where the FIE has yet to receive the full contribution of its total approved registered capital, the FIE's borrowing gap should be in proportion to its paid-in registered capital. In relation to RMB foreign debts, while the PBOC Notice provides that an FIE may only incur RMB foreign debts after its registered capital has been injected in full, our experience in recent transactions reveals that, in practice, certain local authorities adopt a different approach by approving RMB foreign debts to the extent that those debts were in proportion to the paid-in registered capital of the relevant FIE at the time those debts are incurred.

Special regulatory treatment may be available to foreign debts borrowed by enterprises in some special trade zones, e.g., Qianhai¹⁹ and the Shanghai Free Trade Zone.²⁰

¹⁹ Under the *Temporary Measures Regarding Cross-Border RMB Loans in Qianhai* promulgated on 27 December 2012 by People's Bank of China,



Withholding tax and business tax

Except as otherwise provided under any applicable double tax treaty between China and the country in which the foreign lender is located, 10% withholding tax and 5% business tax will be imposed on any interest, fees (such as arrangement fees) and commission payable to the foreign lender who is lending through its head office or a branch located outside China

Therefore, tax gross-up provisions are always required by the offshore lender in a foreign debt loan agreement. Those tax gross-up provisions are generally effective in ensuring that an offshore lender receives a sum net of any deduction or withholding equal to the sum which it would have received had no withholding been required.

Purpose of foreign debt

PRC law provides that loan proceeds denominated in foreign currency (whether or not borrowed onshore or offshore) must not be converted into RMB for the repayment or refinancing of a borrower's existing RMB loans

In respect of RMB foreign debts, according to the PBOC Notice, the borrower is allowed to apply its RMB foreign debts toward the repayment of its existing onshore and offshore debts. However, the loan proceeds cannot be used towards:

Shenzhen City Sub-branch, RMB foreign debts borrowed by enterprises in Qianhai from banks conducting RMB business in Hong Kong for the purpose of financing the construction or development of Qianhai that comply with the requirements set out in *Oianhai Industry Development Manual* do not take up the borrowing gap of the PRC borrower in question.

²⁰ According to the Opinions on Financial Supports to the Shanghai Free Trade Zone issued on 2 December 2013 by People's Bank of China, FIEs, non-banking financial institutions and other enterprises established in the Shanghai Free Trade Zone will be allowed to incur foreign currency and/or RMB foreign debts subject to further administrative measures to be promulgated.

- (a) making financial investments in securities markets or in derivatives;
- (b) buying wealth management products or real estate (except for self use) or;
- (c) (if the borrower is not an investment FIE), making equity investments within China, and/or on-lending by entrustment loans.

Restriction on currency conversion

As pointed out above, RMB is not a freely convertible currency. A PRC entity which has borrowed foreign debts denominated in a foreign currency would need to convert RMB funds/revenue at hand into the relevant foreign currency in order to pay interest or fees or repay the principal of the foreign debt denominated in foreign currency. That conversion and purchase of foreign currency can be done if:

- (a) the foreign debt has been duly registered with its local SAFE; and
- (b) existing foreign currency funds of that company have been used up or are not sufficient for making the requisite payment.

Loans lent by PRC branches/WFOE bank subsidiaries of a foreign bank

If a foreign bank extends a loan to a PRC company through:

- (a) one of its branches located in the PRC; or
- (b) its wholly owned subsidiary incorporated in China (WFOE bank),

that loan does not constitute foreign debt and is neither required to be registered with any local SAFE nor subject to any PRC withholding tax. However, except for export documentary bills purchased under international trade financing facilities, foreign exchange proceeds of



loans lent by the PRC branches of a foreign bank or a WFOE bank cannot be converted into RMB. Therefore, those loans are not an ideal source of working capital, as the borrower can only utilize those loans for offshore uses (e.g., purchasing raw materials or machinery from parties outside China under which payment obligations are denominated in foreign currency).

The M&A Loan Guidelines (defined in the answer to question 6) also regulate loans made by a WFOE bank to a PRC company for the purpose of the PRC company merging with, or obtaining control over, existing companies as a going concern through acquiring assets or existing equity interests, subscription of newly issued capital or debt restructuring (together M&A Loans).

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in China, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

PRC law prescribes that a borrower may not use loan proceeds to engage in equity investment except the proceeds of an M&A loan. On 6 December 2008, the China Banking Regulatory Commission promulgated the Guidelines on Risk Management of Loans Extended by Commercial Banks for Mergers and Acquisition (M&A Loan Guidelines) to regulate M&A Loans obtained from an "eligible lender," which may be used for merging with, or obtaining control over, existing companies as a going concern through acquiring assets or existing equity interests, subscription of newly issued capital or debt restructuring. These are the M&A activities generally described in the M&A Loan Guidelines

The takeover of a public listed company will fall within that description. However, if the acquirer will not obtain any controlling interest in the target company through those M&A activities, the activities will not qualify as M&A Loans under the M&A Loan Guidelines

To address concerns relating to certainty of the availability of bank loans when the takeover bid closes, the lender of the M&A Loan should be a commercial bank incorporated in China²¹ that has met the following stringent requirements:

- (a) it has a capital adequacy ratio of at least 10%;
- (b) it has a loan loss special reserve of at least 100%;
- (c) it has a general reserve balance of at least 1% of the loan balance over the same period;
- (d) it has a comprehensive risk management and effective internal control system; and
- (e) it has a professional team for credit due diligence and risk assessment.

Also, the M&A Loan must have a term of not more than five years and must not exceed 50% of the total amount required for that M&A transaction. The M&A Loan Guidelines also require that an M&A Loan is supported by an adequate security package, such as an equity pledge, mortgage over assets and third party guarantees.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

In general, secured creditors are given priority over equity holders. However, in respect of the enforcement proceeds of security, priority will be given to payment of the following claims before the secured creditors' claims are satisfied:

(a) enforcement expenses (such as auction fees, etc.);

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²¹ The M&A Loan Guidelines are not applicable to PRC branches of foreign banks as they are not distinct legal persons.



- (b) all applicable taxes in respect of the transfer of the relevant charged assets; and
- (c) wages and medical and injury subventions and pensions, and basic pension and medical insurances of staff and workers that are owed by the bankrupt enterprise, and compensation that should be paid to the employee as required by laws and regulations but has not been paid by the bankrupt enterprise before 27 August 2006.²²

Under the Enterprise Bankruptcy Law (effective 1 June 2007) (Enterprise Bankruptcy Law) after the indebtedness to the secured creditors is repaid in priority, the assets of the insolvent enterprise will be distributed according to the following order:

- (a) bankruptcy expenses (including expenses of the bankruptcy proceedings, expenses incurred in the management, sale and distribution of the debtor's assets, and remuneration of officers hired for purposes of the bankruptcy);
- (b) debts incurred for the common benefit of the creditors including:
 - (i) debts incurred for the purposes of requesting a counterparty to enter into a contract which had not been performed by either party;
 - (ii) debts arising by law (such as claims for unjust enrichment);
 - (iii) labor and social security costs arising from the continued operation of the debtor's business;

²² This is under the PRC Enterprise Bankruptcy Law, which was passed on 27 August 2006 and took effect on 1 June 2007. It must not pay amounts arising after 27 August 2006 prior to the payment of the secured indebtedness, i.e., only the wages, medical claims and pensions that occurred before 27 August 2006 must be paid before the secured creditor could receive any payment.

- (iv) damages caused by the operations of the administrator or related personnel; and
- (v) damages caused by the debtor's assets;
- (c) wages and subsidies for medical treatment and disability, old-age insurance premiums, and medical insurance premiums that have been transferred to the employees' personal accounts, as well as compensation for employees as prescribed by the relevant laws and administrative regulations after 27 August 2006 (inclusive);
- (d) social insurance premiums and tax fees as defaulted by the bankrupt enterprise other than those prescribed by paragraph (c) above; and
- (e) ordinary unsecured creditors.

Where the assets of the bankrupt enterprise are insufficient to pay all expenses/debts in a certain category in the above order, the assets will be distributed in proportion to the amount of the expenses/debts owed to the relevant parties in that category.

8. Is interest on debt incurred to acquire a company in China deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Provided that the relevant debt is within the prescribed debt-to-equity ratio and/or in compliance with the arm's length principle (discussed below), interest payments on debts are tax-deductible in China. However, as discussed in the answer to question 6, applying loan proceeds to make an equity investment is not allowed under PRC law.

According to Article 46 of the PRC Enterprise Income Tax Law (EIT Law), interest expenses may not be deducted by a PRC borrower if its debt-to-equity ratio exceeds 5:1 (if it is a financial institution) or 2:1 (if it is not a financial institution) (Thin Capitalization Rule).



In Article 119 of the EIT Law Implementation Rules, "debt" is defined as a financing arrangement which is received, directly or indirectly, by an enterprise from its affiliated parties and for which principal and interest is paid or any other form of compensation of a similar nature to interest is arranged. (This debt includes back-to-back loans through unrelated parties, e.g., entrustment loans and debt raised from third parties and guaranteed or supported by a related party.) "Equity" is defined as an investment for which the invested enterprise need not repay the principal or pay interest, and by which the investor has the ownership of the net assets of the invested enterprise. Interest expense includes interest, guarantee fees, commitment fees and other fees in the character of interest as determined on an accrual basis

According to the Circular on Issues Relevant to the Tax Policies Regarding the Criteria for Enterprises' Pre-Tax Deduction of Interest Disbursements to Affiliated Parties [2008] No. 121 (Circular 121) issued by the State Administration of Taxation (SAT) and the PRC Ministry of Finance and effective on 19 September 2008, a PRC borrower may still deduct its actual interest expenses incurred on an onshore loan arrangement involving its affiliated party as lender that exceeds the Thin Capitalization Rule if the borrower can prove the following:

- (a) that the arrangement is in compliance with the arm's length principle; or
- (b) that the borrower's actual income tax burden is not higher than that of the PRC related party lender.

An intercompany loan arrangement would satisfy the arm's length principle if the interest rate charged is not higher than the "interest rate, for the same period and loan type" charged by financial institutions (e.g., commercial banks, finance companies and trust companies) under basically the same conditions in respect of tenor, amount, guarantee, credit worthiness of the borrower, etc., under the Bulletin of the State Administration of Taxation on Certain Issues of Enterprise Income Tax [2011] No. 34 issued by SAT and effective on 1 July 2011. Please note that the arm's length exception prescribed under Circular 121 only seems to be applicable to domestic loan arrangements and not offshore loan arrangements.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in China?

Contractual subordination is recognized under PRC law.

In general, for an insolvent onshore debtor, its unsecured creditors will rank *pari passu* in terms of debts granted to the insolvent debtor (as discussed in detail in the answer to question 7 above). The Enterprise Bankruptcy Law itself does not specifically address whether contractual subordination (entered into before the PRC company becomes insolvent) would be honored in the case of insolvency of the PRC company. Note that:

- (a) given the principle of *pari passu* under the Enterprise Bankruptcy Law, as long as other unsecured creditors of the debtor that are not party to the subordination arrangements are not adversely affected by the subordination, it is likely that subordination arrangements would be upheld by an administrator; and
- (b) contractual subordination may also be affected by statutory set-off rights. Further, Article 40 of the Enterprise Bankruptcy Law provides that a creditor may request the bankruptcy administrator to set off a debt owed by the insolvent company against any of its debts owed to the insolvent company.

Article 40 further provides that no set-off is allowed if:

- (a) the claim against the insolvent company is acquired by the creditor from a third party after the acceptance of the bankruptcy petition;
- (b) the creditor incurred the debt to the insolvent company despite its knowledge that the company was insolvent, or of the bankruptcy



- petition, unless the creditor incurred such debt by law or for reasons which arose one year prior to the bankruptcy petition; or
- (c) the claim against the insolvent company is acquired by the creditor from a third party despite such creditor's knowledge that the company was insolvent, or of the fact of the bankruptcy petition, unless such claim was acquired by the creditor by law or for reasons which arose one year prior to the bankruptcy petition.

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Colombia

 Is there any prohibition on a company incorporated in Colombia providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

There is no prohibition on a company incorporated in Colombia providing financial assistance unless the target company is:

- (a) a bank (establecimiento bancario);
- (b) a finance corporation (corporación financiera);
- (c) a financing company (compañía de financiamiento);
- (d) a financial cooperative (cooperative financiera);
- (e) a financial services company (sociedad de servicios financieros);
- (f) a capitalization company (sociedad de capitalización);
- (g) an insurer;
- (h) an insurance broker; or
- (i) a reinsurance broker.

Colombian law does not, in general, prohibit financial assistance in connection with the acquisition of shares in the assisting company or its parent company. However, Article 10(c) of the Colombian Financial System Statute (*Estatuto Orgánico del Sistema Financiero*) prohibits the entities listed above from directly or indirectly financing the acquisition of shares (or bonds convertible into shares) in that



financing entity (or of any other financial or insurance company in Colombia).²³

Regular commercial companies are not subject to any specific financial assistance limitations. However, the Colombian supervising authority of commercial companies (Superintendencia de Sociedades) has stated that in order for a company to grant loans, granting loans activity must be expressly included in its corporate purpose as an ancillary activity and the loan must pass a "means-ends" test, i.e. it should be possible to demonstrate that the loan serves the corporate purpose of the company.

2. What are the implications under the corporate benefit laws of Colombia for a company providing financial assistance?

While Colombian commercial companies may provide loans and financing, in general, administrators and officers of companies are subject to "fiduciary" duties under the law. Law 222/1995 (which modified the Colombian Commercial Code (Decree 410/1971 as amended)) (Modifying Law) requires administrators or officers of a company to act in good faith and loyally towards the company. The Modifying Law sets out the duty of administrators and officers to act in the interests of the company, while also considering the interests of the partners/shareholders. Administrators and officers may be held liable if any financial assistance they approve or implement fails to meet these legal duties.

If there are any minority shareholders left out of a buyout transaction financed by the company, the management of the company may be in a conflict of interest situation that needs to be approved by the shareholders. Majority shareholders are only able to approve the

²³ Unless: (a) the shares are acquired in a primary way or under privatization; and (b) the loan is guaranteed with collateral having a commercial value of at least 125% of the financed amount.

conflict of interest if the proposed financing is not detrimental to the company. This means that the financing must meet:

- (a) the "means-ends"; and
- (b) the "arm's length" test.
- 3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security, and if so, what is the basis for calculation?

The following table provides the basic description and estimated costs of the most common types of security used in structuring commercial transactions in Colombia:

Description of Security Interest

1. Security interests over any kind of movable asset

Law 1676/013 (*Law 1676*) came into force during 2014. Law 1676 sets out a new security regime in Colombia for movable assets.

(garantías mobiliarias)

Under Law 1676, it is possible to create a security interest over most types of movable goods²⁴ and some types of economic rights, regardless of the type of agreement executed to document the security interest. Law 1676 applies, among other things, to

Comment

General Comments

Law 1676 contains two new mechanisms for obtaining repossession of secured collateral that may be subject to additional secondary legislation. The mechanisms are:

(i) <u>Direct payment</u>. Parties may agree on a direct payment mechanism. It is thought to be the quickest payment mechanism. It could be agreed on regardless of who holds possession of the assets. If the debtor holds assets and refuses to deliver the assets on enforcement of the security, then the creditor must file a petition for a judge to order the

²⁴ Except for certain movables assets expressly excluded by Law 1676, such as aircraft, vehicles and securities.



conditional sales, pledges over commercial establishments. security interests over accounts receivable, pledges over shares, intellectual property rights, and security trusts.

Parties to a security agreement are permitted to agree on the terms and conditions of the agreement, but the agreement must contain the few, minimum elements required by Law 1676. Some common security interests over movable assets available are:

Comment

repossession.

(ii) Special enforcement or collection. The creditor may seek payment by enforcement of its security interest through the collection procedure set out by the registry created by Law 1676. This procedure is intended to be quicker than conventional judicial proceedings since, in principle, there will be no need to resort to judicial proceedings, unless the debtor opposes a material defence against the creditor (such as the nonexistence of the main obligation). After collection, the creditor may opt for selling the collateral to obtain payment of the debt or to obtain repossession of the collateral.

For the security interest to be enforceable vis-à-vis third parties, Law 1676 created a public registry. Registration of the security interest may be done online rapidly and inexpensively (the cost in 2015 is approximately USD15).

(i) Cash flows trust

Under this type of security interest, the holder of rights to receive a stream of payments (under a contract or otherwise) assigns those rights, in whole or in part, to a trust managed by a professional trustee (sociedad fiduciaria). The trustee then manages the funds on trust in accordance with the instructions contained in the trust agreement.

Costs

- i. Trust fee: As negotiated.
- ii Registration rights paid to the Security Interest Registration Office (Registro National de Garantías Mobiliarias):

USD15 approximately.

Note: other fees and taxes may apply if the cash flows trust does not convey a security interest right e.g.,

Description of Security Interest

The main objective of this type of arrangement is to manage cash flows, but it can also serve as security. (All funds held on trust at the time of an event of default under the loan documentation would be applied towards the payment of outstanding obligations).

Comment

the trust is only used to outsource the management of the cash flow of an operation.

(ii) Security trust over shares

Under this type of security interest, the owner of shares to be delivered as collateral transfers them to a professional trustee who manages that collateral for the benefit of the parties mentioned in the given agreement (e.g., lenders and borrower). The trustee will be able to sell or otherwise dispose of the shares if there is a default or breach of secured obligations. The borrower may or may not keep the assets in its possession. If a default occurs and continues, the trustee may, following the instructions provided under the trust agreement, sell the assets without judicial proceedings and pay the creditors mentioned in the agreement as beneficiaries of the trust, or otherwise deliver the assets held to creditors as payment. This type of security is generally more flexible in terms of documentation and stipulations than a mortgage or

Costs

- i. <u>Trust fee:</u>As negotiated.



Description of Security Interest	Comment
pledge, but it may be more expensive as it will need to include the fees of the trustee.	
(iii) Pledge over the commercial establishment A pledge is a security interest established over personal property (either tangible or intangible). When a pledge is granted over a business concern (a "commercial establishment"), the parties are free to include as collateral circulating goods (e.g., inventories, accounts receivable, accounts payable, raw goods) and in those circumstances, goods sold or otherwise transferred are replaced by others acquired in the normal course of the operations of the commercial establishment.	i. Registration rights paid to the Security Interest Registration Office (Registro de Garantías Mobiliarias): USD15 approximately.
2. Security trust over real estate This is similar to a security trust over shares. The trustee usually grants the debtor the right to continue to use the properties (under a gratuitous loan - commodatum - or lease agreement), unless and until an event of default is declared under the loan agreement.	General Comments This is a fairly popular form of security in Colombia. However, it could be expensive (see below in relation to registration expenses). Cost i. Trust fee: As negotiated. ii. Registration tax: As from fiscal year 2013, the registry tax should be paid in the Land Registry Office of each of the jurisdictions where the real estate is located.

Description of Security Interest	Comment
	The registration rate will be 1% in each of the jurisdictions mentioned above. The taxable base is the total value of the trust fee.
	iii. Notary public fees: Considering that the trust requires the transfer of property rights over real estate, the trust agreement must be contained in a public deed. This generates payment of notary fees at a rate of 0.3% (3 x 1,000) of the value of the trust fee.
	iv. Registration rights paid to the Land Registry Office: As the trust requires the transfer of property rights over real estate, the trust must be registered in the corresponding Land Registry Office. Registration rights of 0.5% (5 x 1,000) of either the value incorporated in the public deed to be registered or the official appraisal of the real estate, whichever is higher.
	v. Registration rights paid to the Security Interest Registration Office (Registro de Garantías Mobiliarias): USD15 approximately.
3. Mortgage Over Immovable Assets A mortgage is a security granted	General Comments This is a popular form of security in Colombia. However, it may be expensive
over real estate, by which the owner establishes a lien as security for the performance of an obligation and the asset	(see below in relation to registration tax), but less so than the security trust over real estate (assuming that the cadastral value of the real estate is less than the



Description of Security Interest

remains the property, and in the possession of, the owner. The mortgage must be granted by the owner of the relevant asset by means of a public deed granted at a notary public's office, and to be effective, it must be registered with the Land Registration Office of the jurisdiction where the property is located. A mortgage allows the creditor to enforce it regardless of whoever the registered owner of the asset is at the time of enforcement. If there is a default, the creditor cannot directly enforce the security but institute judicial proceedings to seek to have the assets publicly auctioned.

Comment

secured obligations).

Cost

i Registration tax:

If the mortgage is an accessory contract, the taxable base is the value of the main agreement²⁵ subject to registration.

Otherwise, the taxable base is the effective loan disbursement to be made by the creditor.

The applicable tax rate is generally 1% and must be paid at the Land Registry Office where the property is located

ii. Notary fees:

The mortgage agreement must be reflected in a public deed, which generates the payment of notary fees at a rate of 0.3% (3 x 1,000) of the value contemplated in the public deed.

iii. Registration rights paid to Land Registration Office (realty trusts):

Registration rights of 0.5% $(5 \times 1,000)$ of either the value incorporated in the public deed to be registered or the official appraisal of the real estate, whichever is higher.

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²⁵ If the main agreement is not subject to registration, the taxable base is the effective loan disbursement

4. How long, following the acquisition of a foreign target company, would it usually take in Colombia for a Colombian subsidiary of that foreign target company to grant a guarantee/security?

The time for granting a guarantee/security will not be affected by the length of time that has passed since an acquisition. The time for granting a guarantee/security will depend on the type and complexity of the structure chosen. A newly acquired company may issue a guarantee/security immediately after being acquired. For example, a pledge agreement must be registered within two business days from the date of execution, a mortgage must be registered within one to two weeks from the date of execution and a trust arrangement must be registered but the timing of the registration depends on the agreement with the trustee.

5. Are there any restrictions on foreign banks lending to companies in Colombia? Are interest payments to foreign banks typically subject to withholding tax?

Overseas banks may freely lend to companies in Colombia, without any restriction on the amount, purpose or terms of the loan. Any overseas company that is not a bank may also freely lend to Colombian companies. However, loans to Colombian companies (and individuals) are subject to foreign exchange rules, which require registration with the Colombian Central Bank (*Banco de la República*) (**BR**) of:

- (a) the loan agreement (and related guarantees);
- (b) the lender; and
- (c) the disbursement.

Also, all disbursements and payments must be conducted via the Colombian "foreign exchange market", i.e., through:



- (a) Colombian banks (and other local financial institutions); or
- (b) accounts held by the Colombian borrower overseas duly registered as "compensation accounts" with the BR.

Foreign exchange rules and mechanisms should be carefully followed as failure to do so may generate substantial fines. There are certain exceptions where a lender is allowed to disburse the loan to a person other than the debtor, e.g. a refinancing business, where the outgoing lender may receive the disbursement directly or an importing business, where the seller of the goods may receive the disbursement directly.

All interest paid to overseas creditors will be subject to withholding tax. The withholding tax rate is:

- (a) 14 %, if the term of the loan is more than one year; and
- (b) 33% if the term of the loan is less than one year.

However, withholding rates may be lower if the lender is incorporated in a jurisdiction that has an enforceable double taxation treaty with Colombia. Colombia has entered into double taxation treaties with various countries including Spain and Switzerland.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Colombia, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Colombian securities regulations require buyers under any proposed takeover of a publicly listed company in Colombia (Public **Acquisition Offer**) to have in place, before making its offer, guarantees supporting performance of the Public Acquisition Offer. The Colombian Stock Exchange (Stock Exchange) is entitled to regulate the special conditions of the relevant guarantees and must inform the market of the existence of those guarantees before the

acquisition takes place. If the buyer is paying in cash for the shares to be acquired, the guarantee may be in any of the following forms:

- (a) cash deposits in Colombian peso in Colombian banks or in other currencies in foreign banks (in favor of the Stock Exchange);
- (b) a banking guarantee or standby letter of credit (subject to sufficient credit ratings);
- (c) an insurance policy issued by Colombian insurers;
- (d) delivery of Colombian public debt securities as collateral to the Stock Exchange; or
- (e) an assignment to the Stock Exchange of participations in mutual funds/investment funds.

If the buyer plans to pay for the shares by providing other securities in exchange, the buyer must provide evidence to the Stock Exchange that the relevant securities are available for the purposes of the transaction and are free of liens/encumbrances.

These rules apply regardless of the source of funding of the buyer.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

The order of priority in which the liabilities of a company or corporation should be paid is:

- (a) pension liabilities;
- (b) liabilities covered by a security interest, mortgage or the assets placed in a security trust up to the amount of the applicable security interest, mortgage or security trust. Security interests granted over the same asset will be ranked on the basis of the order of perfection of the security interest i.e. if there are two



security interests over the same asset, the one that was perfected first will have priority over the other. A purchase-money security interest (a security interest over a movable asset granted to the creditor that financed the acquisition of that movable asset) will take precedence over a floating security interest that was first perfected;

- (c) expenses incurred after the commencement of an insolvent liquidation for the common interest of creditors;
- (d) labor liabilities, however, constitutional challenges that may occur in the future may result in Colombian courts giving priority to labor liabilities over secured creditors:
- (e) general tax obligations; and
- (f) liabilities of tax collectors with tax authorities, liabilities of the debtor with charity or educational institutions funded with public resources and accounts payable to suppliers of inputs or raw materials necessary for the production of goods or rendering of services. The liabilities at this level will be paid on a first-accrued, first-paid basis.

Colombian law will recognize the priority of debt holders over equity holders in the event of liquidation of a Colombian company.

Article 241 of the Colombian Code of Commerce prohibits distribution of sums to a company's partners/shareholders until all "external" liabilities of the company have been paid.²⁶

²⁶ However, Article 241 exceptionally authorizes payment to partners / shareholders of any part of company assets exceeding twice the listed liabilities, without having paid all "external" creditors first.

8. Is interest on debt incurred to acquire a company in Colombia deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Interest paid is deductible for income tax purposes if:

- (a) the withholding is duly made and paid to tax authorities;
- (b) the loan complies with foreign exchange regulations;
- (c) the loan is related to the income-producing activity of the local entity and is necessary and proportionate²⁷; and
- (d) the loan complies with transfer pricing regulations.

Article 118-1 of the Colombian Tax Code, enforceable as of FY2013, introduced the notion of thin capitalization by stating that taxpayers can only deduct interest generated by credit loans (debt) if the total average loaned amount during the taxable period is not greater than three times the taxpayer's net worth, as determined on 31 December of the previous taxable year. Therefore, in addition to the general requirements for the deductibility of expenses, interest paid on loans that exceed a 3:1 debt-to-equity ratio, when compared with the equity of the taxpayer as of the last day of the previous tax year, will not be deductible.

The payment of interest by a local borrower to a foreign lender on loans granted for a term of one year or more is subject to an income tax withholding of 14% of the value of interest effectively paid or accrued.

²⁷ The necessity and the proportionality are viewed from a commercial perspective based on the expenses that are usual in companies engaged in similar business activities.



The amount of the withholding on interest paid on loans granted for a term of less than one year will be subject to income tax withholding at the rates set out in the following table:

FY	Rate
2015	39%
2016	40%
2017	42%
2018	43%

In 2019 and subsequent years the rate is scheduled to decrease to 33%.

Colombia currently has five double taxation agreements (DTAs) in force, with Spain, Canada, Chile, Switzerland, Korea, India and Mexico. In general terms, DTAs provide a reduced withholding rate for payments to lenders domiciled in one of these jurisdictions, as follows:

	Non-financial entity creditor	Financial entity creditor
Mexico	10%	5%
Spain	10%	0%
Chile	15%	5%
Canada	10%	10%
Switzerland	10%	0%
India	10%	10%
Korea	10%	10%

Therefore, a lender group lending money to a Colombian borrower, to the extent possible, should try to fund the loan through one of its affiliates incorporated in the one of the jurisdictions listed above.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Colombia?

Contractual subordination will be honored by a liquidator or bankruptcy trustee in Colombia if both the creditor and the debtor have agreed to it. This should be implemented in the form of:

- (a) an express mandate incorporated in the inter-creditor agreement allowing the senior creditor to receive any amounts due to the subordinated creditor; or
- (b) an appointment of a common agent to receive all proceeds on behalf of a syndicate of lenders.

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Czech Republic

1. Is there any prohibition on a company incorporated in the Czech Republic providing financial assistance in connection with the acquisition of shares in or its parent company (either direct or ultimate)?

Financial assistance in the Czech Republic is regulated by Act No. 90/2012 Coll., on Business Corporations and Cooperatives, as amended (Business Corporations Act), which regulates the provision of financial assistance by:

- (a) a limited liability company (společnost s ručením omezeným);
- (b) a joint stock company (akciová společnost); and
- (c) a cooperative (*družstvo*).

Under the Business Corporations Act, financial assistance may be provided only on the conditions set out below.

Limited liability company

Unless the Memorandum of Association states otherwise, a limited liability company may provide financial assistance if:

- (a) the financial assistance is provided under fair trade conditions, particularly in relation to the interest charged and whether the security given by way of the financial assistance benefits the company; and
- (b) the executive prepares a written report in which he/she factually states the reasons for the provision of the financial assistance, including any advantages and risks to the company, specifications of the conditions under which the financial assistance is to be provided, and states reasons why the provision of the financial assistance is not in conflict with the interests of the company.

The company deposits the report referred to in (b) above in the Collection of Deeds without any undue delay after the general meeting has approved the financial assistance. The report must be made available to the participants at the registered office of the company from the date when the invitations to the general meeting have been sent and must be freely available to the participants of the general meeting.

The above requirements do not apply to financial institutions in relation to the provision of financial assistance if another Act regulates the activities of banks and if that assistance is provided within the ordinary course of their principal business.

Joint stock company

Section 311 of the Business Corporation Act provides that financial assistance may be provided by a joint stock company, if permitted by its articles of association and if at least the following conditions are met:

- (a) the financial assistance is provided under fair market conditions, particularly in relation to the interest charged and whether the security given by way of financial assistance benefits the company;
- (b) the board of directors verifies the financial capacity of the person/entity to whom/which the financial assistance is provided;
- (c) provision of the financial assistance is approved by the general meeting in advance based on a report by the board of directors as detailed in (d) below (adoption of the decision requires approval by at least two-thirds of the votes of shareholders present at the general meeting);
- (d) the board of directors prepares a written report in which it:
 - (i) states reasons for the provision of the financial assistance, including any advantages and risks to the company;



- (ii) specifies the conditions under which the financial assistance is to be provided, including the price for which the recipient of the financial assistance is to acquire the shares;
- (iii) states the results of the financial capacity verification;
- (iv) states why the provision of the financial assistance is in the interests of the company; and
- (v) states, if shares are acquired through financial assistance in the company providing the financial assistance, an adequate price for those shares;
- (e) provision of the financial assistance does not cause any decrease in the equity below the limit of the subscribed registered capital increased by funds that cannot be divided among the shareholders under the Business Corporation Act or the articles of association. taking into account any decrease in equity which may occur if the company (or another entity on its behalf) acquires its shares; and
- (f) the company must create a special reserve fund in the amount of the provided financial assistance (Section 317 applies accordingly).

The company must deposits the report required by Section 311 (d) and the expert's report referred to below in the Collection of Deeds without any undue delay after the general meeting has approved the financial assistance. This report must be made available to the shareholders at the registered office of the company and posted on the company's website from the date of the general meeting at which the financial assistance is to be approved and be freely available to the shareholders at the general meeting.

Where financial assistance is to be provided to a member of the board of directors, a person controlling the company, a member of its statutory body, or a person acting in conjunction with the company or with any of the above persons, or a person acting in its own name but

in lieu of the above persons, a generally recognized expert independent of the company and these persons, as designated by the supervisory board, must review the report provided under Section 311 (d). In his/her/its written report, the expert assesses the correctness of the written report by the board of directors and expressly comments upon whether or not provision of the financial assistance is in conflict with the interests of the company.

These requirements in relation to the giving of financial assistance do not apply where employees are acquiring shares in the company nor where financial assistance is provided by banks and financial institutions, if that assistance is provided within the ordinary course of their principal business.

Cooperative

Unless the articles of association state otherwise, a cooperative may provide financial assistance if:

- (a) the financial assistance is provided on equitable terms;
- (b) the board of directors prepares a written report in which it:
 - (i) states the reasons for the provision of the financial assistance, including specifications of any advantages and risks arising out of this for the cooperative;
 - (ii) specifies the conditions under which the financial assistance is to be provided; and
 - (iii) states why the provision of the financial assistance is not in conflict with the interests of the cooperative.

The cooperative must deposit the above report in the Collection of Deeds without any undue delay after the financial assistance has been approved by a meeting of the members. This report must be made available to the members of the cooperative at the registered office of the cooperative from the convening of the members' meeting and



must be freely available to all members at the relevant members' meeting.

The above requirements do not apply to banks and financial institutions in relation to the provision of financial assistance, if that assistance is provided within the ordinary course of its principal business and if the assistance does not decrease its capital under the limit of the subscribed registered capital increased by funds that cannot be divided among the cooperative's members under the Business Corporation Act or the articles of association.

General

The relevant sections of the Business Corporations Act provide the minimum requirements for the so-called "whitewash procedure". However, corporate founding documents (such as the memorandum of association or articles of association) may provide for further, more restrictive, requirements.

Financial assistance may be provided by a joint stock company or a cooperative only with the prior consent of the general meeting. Subsequent consent of the general meeting is sufficient, however, if the financial assistance is provided by a limited liability company.

If financial assistance is provided without the required consent of the general meeting, provision of the financial assistance might by declared invalid, if challenged by a legitimate person within the period of six months after that person learned (or should and could have learned) of that invalidity, but in any event not later than 10 years after the provision of the financial assistance.

2. What are the implications under the corporate benefit laws of the Czech Republic for a company providing financial assistance?

Financial assistance in the Czech Republic may be provided under fair trade conditions only, particularly in relation to the interest charged

and whether the security provided in relation to the financial assistance benefits the company.

Also, the concept of "due managerial care" of members of the board of directors (and directors in the case of a limited liability company) of a company applies under Czech law. Board members are obliged to perform their functions with the required loyalty, knowledge and care. It is assumed that one acts carefully and with the required knowledge if he/she, when making a business decision in good faith, has acted in an informed manner and in the justifiable interests of the company (the so-called "business judgment rule"). There may be different interpretations of what is in the justifiable interests of a company, but the transaction should in any case at least be beneficial to the company and should serve the company's interests.

Board members are liable for any damage they cause to the company if they neglect their duties. The burden is on board members to establish that they have acted with due managerial care. When assessing whether or not a member of the board of directors has acted with due managerial care, the particular actions of that board member will be compared to the care that would usually be taken by another reasonably acting person in the same situation and facing similar circumstances

Moreover, there are specific provisions of the Business Corporations Act regulating abuse of influence or control. Under these provisions, anyone who makes use of his/her influence in a company to substantially influence the behavior of that company to its detriment is obliged to compensate the company for that detriment, unless the influencing individual shows that it has acted in an informed manner and in the best interests of the company.

By operation of law, the influencing individual is also responsible to the company's creditors for the proper fulfillment of the obligations of the company that the company was not able to fulfill (partially or in full) because it was influenced by the influencing individual.



3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Types of security

The most typical and most common types of security securing debt in acquisition finance transactions in the Czech Republic include:

- (a) as a condition precedent to utilization of the acquisition loan:
 - (i) pledge of shares or participation interest in the acquiring company;
 - (ii) pledge of receivables from intra-group/shareholder loans of the parent company;
 - (iii) pledge of receivables of the acquiring company from the share purchase agreement; and
 - (iv) pledge of receivables from bank accounts; and
- (b) as a condition subsequent after acquisition of shares in the target company:
 - (i) pledge of shares or participation interest in the target company;
 - (ii) pledge of enterprise of the target company;
 - (iii) pledge of receivables from bank accounts of the target company;
 - (iv) pledge of trade receivables of the target company;

- (v) pledge of receivables from insurance policies of the target company;
- (vi) mortgage over real property of the target company; and
- (vii) pledge of movable assets of the target company.

Requirement for a notarial deed

Under Czech law, an agreement on pledge of enterprise (or other collective thing), mortgage over real property which is not registered in the Real Estate Register (*katastr nemovitosti*) and an agreement on the basis of which the pledge over a movable thing will be established on its registration in the public register all require the form of a notarial deed.

An agreement on pledge of participation interest and a mortgage agreement do not require the form of a notarial deed. However, certified signatures must be attached to those agreements.

Creation of the security on registration

Generally, a pledge over an asset registered in a public register is created on registration of the pledge in that public register.

A mortgage over real property is created on its registration in the Real Estate Register (*katastr nemovitosti*). A pledge over a participation interest in a limited liability company is created on its registration in the Commercial Register (*obchodní rejstřík*). A pledge over an enterprise, a collective movable thing and a mortgage over real property not registered in the Real Estate Register are created on their registration in the Register of Pledges (*rejstřík zástav*). It may be agreed between the parties that a pledge over a receivable or other movable thing (not collective) will also be created on its registration in the Register of Pledges. A pledge over a certificated registered share is created by the pledge being endorsed on the share and it being handed over to the pledgee (or, if agreed, to a third party that will hold it for the pledgee).



Tax or Duty Payable on Grants of Security

In general, there is no stamp duty or similar tax on grants of security in the Czech Republic.

Certain forms of pledges require notary deeds, where notary fees are capped at the level of approximately EUR 3,000.

4. How long, following acquisition of a foreign target company, would it usually take in the Czech Republic for a Czech subsidiary of that foreign company to grant a guarantee/security?

Czech law does not provide for any statutory period in relation to granting a guarantee or security by a Czech company in relation to the acquisition of shares in its foreign parent company.

Under Section 41 of the Business Corporations Act, financial assistance includes, among other things, the provision of any kind of security by a company incorporated in the Czech Republic for the purposes of acquisition of shares (or a participation interest in the event of a limited liability company) in that company.

Granting a guarantee or security by the Czech subsidiary for the purposes of acquisition of shares in its parent company (whether foreign or local) by a third party does not fall under the statutory regulations in relation to financial assistance. However, because the Business Corporations Act is relatively new, a more strict interpretation of the law could prevail. A strict interpretation would be that financial assistance relates also to subsidiaries of a target (as this was the case before implementation of this new law). That strict interpretation, however, is not supported by the wording of the law.

5. Are there any restrictions on foreign banks lending to companies in the Czech Republic? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

A foreign bank that carries out lending activities in the Czech Republic is subject to certain licensing requirements under the Banking Act, No. 21/1992 Coll., as amended (**Banking Act**). These requirements differ depending on whether the bank is:

- (a) a foreign bank having its registered office in an EU Member State or within the territory of a member of the European Economic Area (**Member State**); or
- (b) a foreign bank with its registered office in a state that is not a Member State.

A bank that has its registered office in a (home) Member State may carry out lending activities within the territory of the Czech Republic through its Czech branch under a single license in accordance with European Union law. It does not need an additional license granted by the Czech National Bank, if it has:

- (a) been granted authorization to carry out its activities in the home Member State; and
- (b) complied with the required lending procedures under European Union law.

Further, this bank, authorized under the same conditions, may carry out lending activities without establishing a branch in the Czech Republic on the condition that the carrying out of those activities does not have the character of permanent economic activity in the Czech Republic.



A foreign bank, having its registered office in a state other than a Member State (or a bank not enjoying a single license) wishing to carry out lending activities through its branch within the territory of the Czech Republic, is required to submit a license application to the Czech National Bank (CNB). The CNB then decides whether to grant the license after considering whether the following requirements have been met:

- (a) the funds provided by the foreign bank to its branch must be of a sufficient amount and transparent origin, taking due consideration of the scope and risks of the branch's business activities;
- (b) the foreign bank must be trustworthy and have sufficient financial strength, taking due consideration of the scope of the branch's business activities:
- (c) the individuals nominated for executive managerial positions in the branch must have sufficient competence, trustworthiness and experience;
- (d) the branch must have in place the technical and organizational prerequisites for pursuing its proposed activities and a functional and effective management and control system;
- (e) the branch must have a program of operations to support its proposed strategy of activities and based on realistic economic calculations:
- (f) any closely linked group to which the foreign bank belongs must be transparent;
- (g) the close links within the group to which the foreign bank belongs must not impede the exercise of banking supervision;
- (h) in the state within whose territory the group to which the foreign bank belongs has close links, there must be no legal or factual impediment to the exercise of banking supervision;

- (i) the foreign bank wishing to carry out its activities through a branch within the territory of the Czech Republic must have its registered office and its effective office in the same state;
- (j) supervision over the foreign bank in its home state must be performed to the same extent as performed in Member States; and
- (k) the laws of the home state of the foreign bank must provide no impediments to the effective exchange of information between the Czech National Bank and the home state supervising authority of the foreign bank.

Withholding Tax

Interest payments sourced in the Czech Republic and paid to foreign banks are generally subject to 15% Czech withholding tax. A withholding tax rate of 35% applies to interest paid to banks which:

- (a) are not residents of another EU member state or a member state of the European Economic Area; and
- (b) are not residents of a state with which the Czech Republic has concluded a valid and effective treaty for avoiding double taxation, or a treaty for exchange of tax-related information.

This withholding tax is, however, frequently subject to full relief under the applicable tax treaty.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in the Czech Republic, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Takeover bids for publicly listed companies in the Czech Republic are regulated by Act No. 104/2008 Coll., the Takeover Code (**Takeover Code**), which implements Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids.



A takeover bid is defined as a public offer to enter into a security purchase or security exchange agreement that will enable the offeror to control the target company or to fulfill an obligation under the Takeover Code

Under the Takeover Code, an offeror may disclose an intention to make a takeover offer only after ensuring that it will be able to provide cash consideration in full to all offerees and after taking all measures to secure the implementation of any other type of consideration, if being provided.

A takeover bid is made by publication of an offer document containing, among other things, information about the resources of the offeror, financing of the takeover bid and other details in relation to the consideration for the offer.

The offer document must be reviewed by the CNB before its publication. The offeror submits a draft offer document to the CNB within 15 days after making the decision to make the takeover bid. The CNB does not issue an express approval but it may prohibit publication of the offer document. If the CNB does not prohibit publication of the offer document within 15 working days after its submission, the offeror is then obliged to publish the offer document no later than 30 working days after the submission. The CNB may also inform the offeror that it does not object to the offer document before the end of the 15-day period. This also triggers the offeror's right to publish the offer document.

The CNB may require the offeror to provide evidence to show that the offeror has sufficient resources available to finance the takeover and attest to their origin. The CNB may also prohibit publication of the offer document if the offer document is incomplete, contains apparently false or misleading information or if the offeror failed the requirement to evidence the availability of sufficient resources to finance the takeover and attest to their origin. The CNB may also require the offeror to amend the offer document or publish additional information with the offer document.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

According to Act No. 182/2006 Coll., the Czech Insolvency Act (**Insolvency Act**), creditors should be paid out to the greatest extent possible and essentially on a pro rata basis.

Secured creditors have right to be paid out (to the extent of their security) from the realization of a thing, right, receivable or other assets securing their debt. If one asset has been pledged in favor of more than one creditor, the order of satisfaction of those creditors will be based on the time of registration of the pledge (or other form of security) in the public register and, if not registered, then based on the time of creation of the pledge (or other security). The later-created security registered in the public register will have priority over the earlier-created security not registered in the public register.

If the value of a security is lower than the amount of the secured debt, the difference between the value of the security and the amount of the secured debt is treated as an unsecured debt.

In that case, only some secured creditors are satisfied from the security (due to the insufficient monetization value) and debts owing to other secured creditors who were granted security later are deemed to be unsecured in full. This however occurs only after the monetization of the security. Therefore, all of the secured creditors should initially assert their debts as secured, regardless of the potential value of the security. By the realization of the thing, right, receivable or other assets during the insolvency proceedings, the security securing the debt of a secured creditor ceases to exist, regardless of whether the creditor did or did not register its debt in the insolvency proceedings.

Under the Insolvency Act, the creditors may register their debts from the beginning of the insolvency proceedings (filing of the insolvency petition). After the insolvency is declared (usually several weeks after



the insolvency proceedings are declared) the court sets a period of two months by which all the debts must be registered. If the debts are not registered after the initiation of the insolvency proceeding, nor within the two-month period after the declaration of insolvency, they can no longer be registered. The exception to this rule applies to foreign creditors residing or seated in one of the Member States. In that case, the registration period commences on the insolvency court explicitly notifying the creditor on the initiation of the insolvency proceedings. Both the secured and unsecured debts therefore need to be registered.

Secured creditors are entitled to satisfaction of their debts from the proceeds of security at any time during the course of the insolvency proceedings, whereas an unsecured creditor can usually have its debts satisfied only after conclusion of the insolvency proceedings (exception to this rule is a so-called partial distribution of assets which must be proposed by an insolvency administrator and approved by an insolvency court).

However, according to the Insolvency Act, all debts owing to secured creditors and general unsecured creditors are to be satisfied after payment of the following priority debts:

(a) debts the estate incurred after initiation of the insolvency proceedings (i.e. costs and fees of the preliminary insolvency administrator, expenses and fees of the court-appointed liquidator and enterprise administrator, expenses and fees of members and substitute members of the creditors' committee, reimbursement of costs for advances for insolvency proceedings incurred by a third person, debts incurred within the protection period arising typically from agreements which are material for the debtor to maintain its operation (e.g., agreements for energy, water and other commodities the supply of which cannot be terminated by the creditor during the protection period irrespective of whether the debtor is late with its payments), and debts arising from loan agreements entered into by the debtor during the protection period or the insolvency administrator to maintain the operation of the debtor's business):

- (b) debts the estate incurred after the ruling on insolvency (i.e. expenses and fees of the insolvency administrator, expenses incurred in relation to maintenance of any real property, expenses and fees of the insolvency liquidator, expenses and fees of the court-appointed expert, taxes, fees, social, health and pension insurance payments, claims of creditors stemming from agreements the fulfillment of which was not refused by an authorized person, debts stemming from agreements permitted by an authorized person, debts corresponding to their right to performance under agreements the fulfillment of which was refused by the authorized person, reimbursement of expenses incurred by persons who provided assistance to the insolvency trustee, and other claims so designated by the Insolvency Act); and
- (c) debts ranking *pari passu* with debts against the estate (i.e. debts owing to the debtor's employees stemming from their labor law relationship with the debtor, debts stemming from compensation for damage to health, debts owing to the state labor offices, debts owing to parties in relation to supplemental pension insurance subsidized by the state, debts stemming from statutory alimony, reimbursement for costs incurred by third parties in increasing the value of the property of the estate, debts incurred during a protection period granted prior to the insolvency proceedings, and other claims so designated by the Insolvency Act).

The Insolvency Act does not distinguish between any particular kinds of security. Secured creditors are, in principle, treated *pari passu* in insolvency proceedings (except the ranking which distinguishes the order of the creditor satisfaction). Each secured creditor has the right to instruct the insolvency administrator how to dispose of its respective security.

The order of priority on an insolvent liquidation may also be affected by debt subordination agreements. Subordinated debts are to be paid



after full payment of all other valid debts within the relevant insolvency proceedings.

8. Is interest on debt incurred to acquire a company in the Czech Republic deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Interest accrued on debt used for acquisition of shares in a company is generally not tax deductible. Merger of the acquisition vehicle and the target company is frequently used to secure the tax deductibility of the interest

Czech thin capitalization rules limit deductibility of interest accrued on loans provided by related parties. In general, any interest paid on a related party loan exceeding four times the equity of the debtor is treated as non-deductible.

Will contractual subordination be honored by a liquidator or bankruptcy trustee in the Czech Republic?

The Insolvency Act recognizes contractual subordination. In particular, Section 172 prescribes that after all debts covered by the insolvency proceedings have been paid in full, subordinated debts and debts owing to the debtor's partners or shareholders (as the case may be) stemming from their membership in the company or cooperative may also be satisfied in the insolvency proceedings.

Subordinated debts are defined as debts to be satisfied, under an agreement, only after other debts are satisfied. Moreover, a debt from a subordinated bond under Act No. 190/2004 Coll., on Bonds, should also be deemed to be a subordinated debt.

Subordinated debts are paid out based on the agreed or stipulated degree of their subordination. Debts of the debtor's partners or members stemming from their membership in the company or cooperative are always satisfied last, on a pro rata basis.

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France

1. Is there any prohibition on a company incorporated in France providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Definition

The term "financial assistance" refers to any advance of funds, any granting of loans and/or any granting of security interests and personal guarantees (Financial Assistance).

Strict prohibition

French law provides for a very strict prohibition against financial assistance being provided by a stock company (société par actions) for the purchase of its own shares. Article L. 225-216 of the French Commercial Code unequivocally states that:

"A company shall not advance funds, grant loans or grant security interests with the view to enable the subscription or purchase of its own shares by a third party."

This prohibition applies to all types of French stock companies.

The prohibition against the giving of Financial Assistance applies to the direct and indirect acquisition of a French stock company. Consequently, that prohibition equally applies in relation to the direct acquisition of shares of the French company and in relation to any indirect acquisition of its shares, through the purchase of the shares of its parent company, either direct or ultimate parent, whatever the law of incorporation of the parent company.

The prohibition on granting security interests or personal guarantees applies in relation to the securing/guaranteeing of any initial acquisition loan and also to any refinancing of that initial acquisition loan.

No whitewash

There are no "whitewash" or equivalent procedures available under French law to overcome the prohibition. This therefore has a material impact on the way leveraged financings and their security packages are structured in France as follows:

- (a) the prohibition against Financial Assistance in the context of an acquisition financing does not prevent the acquiring SPV as borrower (Borrower) of an acquisition loan facility from granting a share pledge over the shares of the French target company (Target) newly acquired through the bank financing (as the shares of the Target are not deemed to be the Target's assets but rather those of the Borrower); and
- (b) it is not possible under French law to have the Target's assets (nor the assets of any French law incorporated subsidiary of a target company, whatever the law of incorporation of that target company) secure the acquisition loan facility (or the acquisition tranche of the global financing to be secured) and these assets are typically excluded in their entirety from the scope of the secured property (as are personal guarantees from these French companies) in the context of the acquisition financing. This means that no security can be taken at all over these assets and that no guarantee may be granted by these French companies to secure/guarantee the acquisition financing.

In addition to prohibiting the granting of security interests and personal guarantees under acquisition financing as set out above, French regulations directly prevent the granting of intra-group loans/advances by a Target (or any French law incorporated company in a target group) for the purposes of directly financing the acquisition or refinancing/repaying the acquisition loan facility.

Certain procedures may be utilized to try to mitigate the inconvenience of the French regulations prohibiting Financial Assistance in the context of an acquisition (for example merger of the



Borrower and the Target or debt push down). These procedures may be at risk of being deemed by a French judge to be a deliberate attempt to bypass the prohibition against the provision and should therefore be regarded with prudence and caution.

Penalties

Serious penalties may be incurred for a breach of the prohibition set out in Article L. 225-216 of the French Commercial Code. Any transaction deemed to breach the prohibition on unlawful Financial Assistance may be declared null and void and the managers of the company may be held liable for mismanagement if the company or its creditors suffered any damages from the disputed transaction. Furthermore, Articles L. 242-24 § 3 and L. 244-1 of the French Commercial Code provide that the president and the managers of a French stock company may be held criminally liable for a breach of the Financial Assistance prohibition.

Companies not being incorporated as stock companies

Article L.225-216 of the French Commercial Code applies to stock companies (sociétés par actions) only. There are no similar restrictions of law applying to the other forms of companies governed by French law, be they commercial (e.g., société à responsabilité) or civil (e.g., société civile, société en nom collectif). However, in any event, the granting of loans, security interests or guarantees for the purpose of the direct or indirect acquisition of its own shares may trigger corporate benefit issues regardless of the form of company involved.

2. What are the implications under the corporate benefit laws of France for a company providing Financial Assistance?

Strict regulation

As indicated above, it is not possible for a French stock company to provide Financial Assistance for the purpose of the (direct or indirect) acquisition of its own shares. As the prohibition is absolute and not subject to any exemptions, there is no reason to analyze any requirement applicable with respect to corporate benefit for a French stock company in relation to granting a loan, guarantee and/or security for the purpose of assisting a third party to acquire (directly or indirectly) the shares of that French company.

To the contrary and as indicated above, where a French company not incorporated in the form of a stock company is to be involved in providing Financial Assistance for the purpose of the (direct or indirect) acquisition of its own shares, prior analysis of the compliance of the operation contemplated with the corporate benefit (intérêt social) of such company shall be carefully carried out.

Where the financing to be put in place in the context of an acquisition also includes additional loan tranche(s) (such as refinancing of existing indebtedness not linked to the acquisition of a French company, working capital facilities for the Target and/or Target group members and/or capex for Target and/or Target group members²⁸). one should consider whether or not a French company may grant a loan, guarantee and/or security to secure the obligations of its affiliates under that additional financing, without breaching laws applicable to corporate benefit (intérêt social). It may also be the case that a French company directly accedes to the financing as borrower, in which case it may freely grant any security or guarantee to secure its own obligations under the financing as borrower.

As a general remark, it should be noted that corporate benefit laws are also guite strict in France. Article L. 242-6 § 3 of the French Commercial Code prohibits any transaction (including loan, security and guarantee) that is contrary to the interest of a company on whose behalf a transaction is concluded.

the context of a secondary LBO is not included in this list as French companies are prohibited from granting security or a guarantee in relation to this tranche due to the prohibition against unlawful Financial Assistance).

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²⁸ The tranche dedicated to the refinancing of a previous LBO financing in



Criteria

Upstream and cross-stream guarantees and security are subject to corporate benefit rules and can only be granted if it is in the "corporate interest" (intérêt social) of the French company to grant the guarantees/security. This appraisal is, in practice, carried out on a stand-alone basis at the level of the company rather than at the level of the group to which the French company belongs. French courts have consistently held that where a transaction is entered into by a company in favor of another company belonging to the same group, that transaction will not be considered as a misuse of corporate assets or credit within the meaning of Article L. 242-6 § 3 of the French Commercial Code (and therefore will not breach corporate benefit regulation), if the following conditions are met:

- (a) a genuine group of companies must exist (as opposed to a mere conglomerate) and the transaction must be justified by the existence of a common economic, financial or labor interest and entered into within the framework of a policy defined for the group as a whole;
- (b) the financial burden borne by a given company within the group as a result of the transaction must not be devoid of due consideration or upset the balance between the respective undertakings of the companies in the group; and
- (c) the financial support granted by the company should not exceed the financial capabilities of that company.

The granting by the French company of the relevant guarantee/security has to comply with these criteria.

In practice, the general view is that a French company can only grant a guarantee/security to guarantee/secure the obligations of a parent company if it does receive some form of true and adequate benefit as consideration for the issue of the guarantee or the granting of the security.

This concept of true and adequate benefit in this context is determined on a case-by-case basis (for example financial remuneration, existence of cross-guarantees in favor of the company, interest of the company in the financial success of the Borrower or the group). In all cases, it is important that the risk assumed by the company acting as grantor and/or security provider should not considerably exceed the benefit derived from the transaction.

Limitations

Practically, the overall commitments of the French entity under the guarantee/security need to be limited if that company only acts as guarantor in relation to a financing. There is, generally speaking, a commonly established approach in relation to dealing with corporate benefit matters in the French market in relation to guarantees. Guarantee and security limitations are negotiated and implemented so that the risk of the nullity of the security and the civil and criminal liability of the managers of the French collateral provider are mitigated as much as possible, as it is considered that all parties to the financing have a common interest in removing these risks. Accordingly, the liabilities of a French company belonging to the target group for upstream and cross-stream guarantees and security are generally limited by reference to amounts derived from the financing and on-lent to the French company by way of intra-group loans and outstanding (with a reference to set-off of the intra-group liabilities in case of enforcement of guarantees and security). Downstream guarantees are more generally permitted but may remain subject to certain limitations.

Whether or not the granting of a particular guarantee or security (or the granting of a loan) is in the interest of the company is a matter of fact, rather than law. This factual determination is made by the management of the French company in its sole discretion, by considering the above criteria. That determination (which will usually be expressly mentioned in corporate resolutions), however, is not binding on a French court that ultimately will make a determination on the basis of its own appraisal of the facts.



Penalties

Criminal penalties (imprisonment of up to five years and/or a fine up to EUR 375,000) can be imposed on the president and managers of the French company if the issue of a guarantee or the granting of security is judged to have constituted a breach of the corporate benefit law. The absence of a corporate benefit could also render the relevant guarantee/security unlawful by a decision of a French court and therefore unenforceable against the grantor. This also explains why lenders pay particular attention to having adequate limitations implemented in the financing documentation.

3. What security can typically be granted over shares and assets? What are the technical requirements (for example notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Governing law

As a matter of principle, it is to be noted that French law should govern security over French assets on the basis of lex rei sitae although a guarantee obligation can be created under any valid governing law that does not violate French public policy. An obligor is therefore predominantly expected to provide security governed by French law over its French assets

Typical security

A security package in France typically consists of separate security documents covering, in almost all cases, pledges of shares (depending on the form of company involved, a different legal regime may apply) and pledges over bank accounts. Receivables are also sometimes subject to security (either in the form of a civil law pledge or under a security assignment mechanism where specific requirements are fulfilled). Other intangible assets, such as intellectual property rights (if available) may also be subject to security.

Pledges over a whole business (*nantissement de fonds de commerce*) may be included in a security package. These pledges typically cover the following elements:

- (a) trading name;
- (b) rights over the commercial lease;
- (c) clientele;
- (d) commercial fixtures;
- (e) machinery and equipment dedicated to the operation of the business; and
- (f) certain intellectual property rights.

However, inventory cannot fall within the scope of a general debenture, and therefore may only be pledged under a specific security, the form of which will be subject to particular attention depending on the context (i.e., commercial or civil form of security being available).

There is no equivalent of a floating charge under French law, which is a key difference between French law and English law.

Notarization, tax and other approvals

To create French law security over the above-mentioned assets, there is no notarization required or tax and stamp duty payable (subject to a few exceptions, e.g., for an ongoing business pledge but always for a lump sum of a low amount), except that certain costs (again, being of a very minimal amount) must be paid to the commercial court or IP register for the purpose of the registration of the security.

No governmental approval or other authorization from a French public body must be obtained for the creation of the above security interests.



Security over real property

Certain other kinds of assets are often excluded from the typical security package in an acquisition financing. In particular, real estate mortgages are usually reserved for property financing transactions only (and are, of course, in that context the key security of the financing). This is due to onerous registration requirements and high notarial fees and costs associated with the creation of any French security over real property. Lending banks, however, decide on a caseby-case basis whether to take security over real property.

Enforcement

Furthermore, some types of security may need to be publicly registered to be effective. The power to enforce security is restricted on the commencement of insolvency proceedings, as a result of a general principle that insolvency law prevails over security law.

No assignment of contractual rights

Finally, it is worth noting that under French law it is not possible to assign contractual rights by way of security. This is in marked contrast to English law and other related common law legal systems.

4. How long, following acquisition of a foreign target company, would it usually take in France for a French subsidiary of that foreign target company to grant a quarantee/security?

Practically speaking, almost all security and guarantees can be granted on the date on which the acquisition occurs.

Lenders do pay attention to hardening periods (the period during which a transaction is vulnerable potentially to being set aside under insolvency legislation) and therefore tend to insist to the extent possible that security and guarantees are provided no later than the date on which the financing is made available.

5. Are there any restrictions on foreign banks lending to companies in France? Are interest payments to foreign banks typically subject to withholding tax?

French Banking Monopoly

Under French banking law, the activity of lending money performed on an onerous and habitual basis is characterized as a "credit operation," which enters into the scope of the French banking monopoly. Therefore, any entity willing to carry out lending activities in France on a regular and onerous basis shall be (subject to a few exemptions) duly licensed to operate such activities in France either through a French banking license or via its European passport on the basis of a license obtained for the same banking operations in another European Union (or European Economic Area) member state.

Withholding Tax

Interest payments made by French entities outside France are not subject to withholding tax, except for payments made in a non-cooperative state or territory (NCCT – état ou territoire non coopératif), a list of which is reviewed and published annually. For payments made in an NCCT, a 75% withholding tax applies (subject to more favorable provisions of any applicable double tax treaty). For 2016, the list of NCCTs for France is as follows: Brunei, Guatemala, Niue, the Marshall Islands, Nauru, Botswana and Panama. Interest paid to a resident of a NCCT is not deductible, unless the French payer demonstrates that the interest relates to real activity and is not abnormal or excessive, and that these payments do not have as their main purpose and effect the localization of that income in an NCCT.



6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in France, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

There are no regulations or public market rules applicable in France expressly requiring certainty of the funds, if a bank debt is necessary to finance a takeover bid.

The reason for this is that French capital market law requires that any takeover bid be filed by a presenting bank (banque présentatrice), acting on behalf of the bidder, which underwrites the bidder's undertakings to purchase the securities subject to the takeover bid and to maintain this offer from the beginning to the end of the bid procedure. The presenting bank is notably subject to the control of the French financial markets authority (*Autorité des Marchés Financiers*) and regulated by its regulations (Réglement Général de l'Autorité des Marchés Financiers). If the bidder resorts to a bank debt to finance the purchase of the security subject to the takeover bid, it will be totally neutral for each seller responding to the bid. Each seller will be paid by the presenting bank in accordance with the terms of the bid. even if the bank debt is finally not available for any reason whatsoever. This is the reason why "certain funds" requirements in relation to bank debt do not exist under French law

Usually the bidder will be asked by the presenting bank to counterguarantee the bank's liabilities and obligations vis-à-vis the shareholders of the target company, with that counter-guarantee taking various forms depending on the transaction (from cash collateral to parent guarantees).

Finally and as a general note in relation to the certainty of funds concept, "certain funds" terms are now rather common in the French leveraged financing market (at least for deals of a certain size and for strong sponsors).

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Article L. 641-13 of the French Commercial Code lists the order of priority of creditors who will be paid ahead of other creditors in the context of an insolvent liquidation (*procédure de liquidation*). Secured creditors and debt holders are given priority over equity holders or shareholders, who will rank last amongst creditors.

The order of ranking of creditors in the context of an insolvent liquidation procedure is the following:

- (a) employees' wages (called super privileged creditors), arising from Articles L. 3253-2, L. 3253-3, L. 3253-4, and L. 7313-8 of the French Labor Code;
- (b) claims arising from procedure expenses incurred after the opening judgment of the procedure;
- (c) claims arising from an agreement approved by a judge to ensure the continuing of the company's activity (excluding claims for capital injections made by owners/shareholders in the context of a capital increase which would be ranked with shareholder/equity claims at (i) below);
- (d) secured creditors with certain types of security, such as a real property mortgage or a charge over the company's assets with a right of retention or a pledge over tools and equipment;
- (e) claims due but unpaid arising from the opening judgment of the procedure for the needs of the procedure or to partially maintain the company's activity during a short period or as compensation for an employee benefit provided to the debtor to maintain the company's activity;
- (f) claims due but unpaid arising from the opening judgment of the procedure for the needs of the procedure or the observation



period, or as compensation for an employee benefit provided to the debtor within this period;

- (g) other secured creditors not mentioned in (d) above;
- (h) unsecured creditors; and
- (i) shareholders or equity holders, who are paid only after all other creditors have been paid.
- 8. Is interest on debt incurred to acquire a company in France deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Interest payments on debt used to fund an acquisition are taxdeductible in France. There are, however, a number of rules that limit debt deductions. The main limitations are the following:

- (a) there is a limitation in relation to interest paid to related entities when those related entities are subject in their jurisdiction to taxation on that interest at a rate below 8.33%;
- (b) there is a limitation on the interest rate charged on related party debt, that is the interest rate cannot exceed a quarterly published rate (2.15% for FY closed on 31 December 2015) or a market rate if higher;
- (c) thin capitalization rules, under which interest paid on related party debt that exceeds the highest of the following three limits is not deductible:
 - (i) interest exceeding a debt/equity ratio of 1.5:1;
 - (ii) interest exceeding 25% of the borrowing company's adjusted operating profits before tax; and
 - (iii) interest exceeding the amount of interest received from related entities

Thin capitalization rules also apply to bank loans secured by related party guarantees, with some limited exceptions (including any pledge over the shares in the borrower or over a receivable owed by the borrower);

- (d) there is a limitation on financial expenses on the acquisition of shares when the French purchasing company cannot demonstrate that it effectively controls or has sufficient influence over the purchased company, except when it can be demonstrated that the acquisition is not financed by a loan;
- (e) a general interest deduction limitation applies to companies whose net financial expenses exceed EUR 3,000,000 per annum. When exceeded, the net financial exposes incurred by the company are deductible only for 75% of their amount; and
- (f) specific rules apply for financial interest deduction in taxconsolidated groups.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in France?

In accordance with French bankruptcy law, contractual subordination does not create binding obligations on a liquidator or bankruptcy trustee, but it may be taken into account by them. The influence of contractual subordination arrangements varies depending on the kind of French insolvency proceedings, i.e. insolvent liquidation procedure (procédure de liquidation judiciaire), safeguard procedure (procédure de sauvegarde) or conciliation procedure (procédure de redressement judiciaire).

Insolvent liquidation procedure

In the context of an insolvent liquidation procedure (Articles L. 640-1 et seq. of the French Commercial Code (*Code de commerce*)), the distribution of assets of the liquidated entity is made by the liquidator (*liquidateur judiciaire*) organized on the basis of the principle of priority rights granted to secured creditors (legal and contractual



privilege), and then to unsecured creditors ranking after the secured creditors and being treated on the basis of the principle of equality of treatment (Article L. 643-1 et seq. of the French Commercial Code). Only those legal principles and ranking apply and are binding on the liquidator. Therefore, contractual subordination will not be honored by the liquidator in this context. The developments below in relation to relationships between junior and senior secured creditors are also relevant in the context of an insolvent liquidation procedure.

Safeguard procedure and conciliation procedure

In the context of a safeguard procedure (Articles L. 620-1 et seq. of the French Commercial Code) or a conciliation procedure (Articles L.611-4 et seq. of the French Commercial Code), the principle of nominal value of money (Article 1895 of the Civil Code) gives to creditors proportional rights to vote for the safeguard or conciliation plan as members of the unsecured creditors' committee. These rights depend on the amount of the creditors' claims. However, the safeguard plan (plan de sauvegarde) or conciliation plan (plan de redressement) can adopt an unequal treatment amongst existing creditors, if the situation requires it to allow for a successful conciliation or safeguard. The plan can create a different treatment of the creditors involved if the situation justifies it. Therefore, a subordination arrangement may be taken into account by the insolvency trustee to put into effect the principle of general equity (principe d'équité) among creditors.

Article L. 626-30-2 of the French Commercial Code provides that the proposed plan "may take into account the subordination contract entered into prior to the opening of the procedure". This sentence must be understood as granting an option and not placing an obligation on the insolvency trustee. The unsecured creditors' committee will then vote by a majority of two-thirds. Under an insolvency proceeding, senior creditors as well as junior creditors are no longer bound by prior contracts. As members of the unsecured creditors' committee, they may vote without taking into account the provisions set out in the subordination contract. To circumvent these constraints, subordination

contracts often include a "claw back clause" that binds the junior creditors to, in practice, pay back to senior creditors amounts they receive from the insolvency trustee. On the basis of these arrangements, the senior creditors are allowed to rely on contractual liability of the junior creditors in the civil courts if the junior creditors do not comply with their contractual obligations *vis-à-vis* the senior creditors.

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Germany

 Is there any prohibition on a company incorporated in Germany providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Financial assistance

As a general rule (under section 71a (1) sentence 1 of the German Stock Corporation Act (*Aktiengesetz*, *AktG*) (**Stock Corporation** Act)), German law does not allow a stock corporation (*Aktiengesellschaft*, *AG*) to provide financial assistance to a third party for the acquisition of the stock corporation's own shares. The prohibition does not apply, however, to a limited liability company (*Gesellschaft mit beschränkter Haftung*) (**GmbH**). Financial assistance is therefore generally permitted for limited liability companies, unless the act of financial assistance violates capital contributions and maintenance provisions. These capital contributions and maintenance provisions contain extensive limitations and can lead to the same effect as the prohibition in section 71a (1) sentence 1 of the Stock Corporation Act.

Capital maintenance

Under German law, granting security in favor of shareholders and affiliated companies (other than subsidiaries, i.e. a company granting security over its assets for debt incurred by its shareholder or affiliated companies (**Up-/Cross-stream Security**)), may, if that security is enforced, be deemed to be a prohibited repayment of the registered share capital to the shareholders and/or may endanger the corporate existence of the company granting the security. To avoid liability of the shareholders or the management of a GmbH, the enforcement of any Up-/Cross-stream Security is generally subject to certain restrictions.

Under section 30 of the German Act on Limited Liability Companies (**Limited Liability Companies Act**) a GmbH (or in the case of a

GmbH & Co. KG, its general partner) may not pay out to its shareholders any funds that are required to maintain the GmbH's registered share capital.

In general, any direct payment to the shareholder that affects the registered share capital is prohibited. All kinds of other distributions from which the shareholder benefits directly or indirectly (e.g., if the company grants security over its assets for debt incurred by its shareholder or affiliated companies), may also violate the restrictions set out in section 30 of the Limited Liability Companies Act.

If a creditor enforces an Up-/Cross-stream Security to satisfy its claims against the shareholder, this qualifies as a payment of funds to the shareholder for the purposes of section 30 of the Limited Liability Companies Act. The limitations arising from section 30 of the Limited Liability Companies Act apply in relation to the shareholder only and do not restrict the secured party from enforcing the security. Therefore, the relevant secured party can enforce the security in breach of section 30 of the Limited Liability Companies Act and the shareholders, as well as the managing directors of the company, may become liable to reimburse the amounts equivalent to the amounts required for the preservation of the registered share capital (sections 31, 43 Limited Liability Companies Act).

Corporate Existence

The management of the German company and the borrower may be held personally and/or, in very rare cases, criminally liable. Under section 64 of the Limited Liability Companies Act, managing directors of a GmbH may be liable for all losses and damages the company suffers itself, if their dispositions or actions led to the insolvency and did not act with the diligence of a prudent business man/woman

The essential element is the drawing of liquidity from the German company. According to relevant literature, the granting of Up-/Cross-



stream Security must be treated as a payment in the sense of section 64 sentence 3 of the Limited Liability Companies Act.

Payments to a direct or indirect shareholder by way of Up-/Crossstream Security may also conflict with the rules and principles of an action threatening the corporate existence (actions causing insolvency), i.e. the prohibition to transfer assets to a shareholder, if that transfer could deprive the GmbH of its ability to meet its obligations towards other creditors when due (section 43 (3) of the Liability Companies Act and section 826 of the German Civil Code (Bürgerliches Gesetzbuch) (Civil Code)). If the company disposes of an asset to a shareholder, the company must consider whether:

- (a) the company will be able to fulfill at all times its other obligations as and when they become due; and
- (b) the disposal may jeopardize the existence of the company (existenzgefährdender Eingriff).

Limitation Language

To avoid liability of the shareholders or the management of a GmbH, the enforcement of any Up-/Cross-stream Security is generally subject to certain restrictions. The relevant provisions in finance documents (i.e. the loan documentation, any guarantee and any security document) are referred to as limitation language, which effectively prevents the secured parties from enforcing the security in certain circumstances that would trigger that liability. This means that enforcement by the bank under the finance documents is generally only permitted against the net assets of the company, i.e. the company's assets, deducting liabilities and the registered share capital. From a bank's perspective, this limits the value of any security obtained, but it is the market standard.

Debt Push Down

To improve the position of the lenders, in particular in the context of an acquisition financing, it is important to structure the financing so

that the relevant German security providers become either the "borrower" under the acquisition financing or, less preferably, that they benefit from the financing by way of on-lending.

This can be achieved by way of a so-called "debt push down," where either existing debt of the relevant company is discharged with proceeds stemming from the acquisition financing or where a borrower is merged with the German company.

2. What are the implications under the corporate benefit laws of Germany for a company providing financial assistance?

There are no corporate benefit laws in Germany. However, managing directors have a statutory duty to their company to act as prudent businessmen/women. This is a vague concept and the interest of the company group can be taken into account when assessing whether it has been met

The German Code of Corporate Governance (GCCG) applies to German listed stock corporations (*Aktiengesellschaften*). Members of the managing board (*Vorstand*) and of the supervisory board (*Aufsichtsrat*) must declare that they have followed the recommendations of the GCCG

If there is a violation the transaction is not invalid but the directors, managing board, or supervisory board are potentially liable.



3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Share Pledge

The share pledge is an accessory security²⁹ that gives the pledgee the right to seek enforcement against the pledged shares of a German company after an event of default has occurred.

German law requires a pledge over shares of a company to be notarized and the parties, or attorneys of the parties, need to appear before a German notary public. It is market-standard in Germany that the power of attorney of the security grantor (and the company, if party to the share pledge) is notarized and, if the shareholder is located outside of Germany, legalized or apostilled. Granting a share pledge is likely to be costly, as the notarial fees are calculated based on the value of the pledged shares. The company whose shares are being pledged also needs to be notified of the share pledge agreement for such agreement to become valid.

For the enforcement of the pledge, the competent German court of execution normally determines whether or not the pledged shares will be sold by public auction or discretionary sale. In general, amending agreements between the parties in relation to the realization of the pledge are possible, but may not be agreed on before the maturity of the pledge. If the shares are sold by public auction, the public auction is conducted by a bailiff.

²⁹ Under German law one differentiates between accessory and non-accessory

security. Accessory rights are dependent on the secured obligations and cease to exist if the secured obligation ceases to exist; non-accessory rights are independent from the secured obligation.

Land Charge/Mortgage

There are two methods of taking security over real estate in Germany:

- (a) the mortgage (*Hypothek*), which is an accessory right; and
- (b) the land charge (Grundschuld), which is a non-accessory right.

As the land charge is independent of the primary payment obligation, the parties enter into a separate security purpose agreement describing the secured obligations and the trigger events that entitle the secured creditor to enforce the land charge. Both security rights require registration in the land register (*Grundbuch*) of the relevant local court (*Amtsgericht*).

It is market practice in banking transactions in Germany to take land charges; mortgages are used only very rarely.

Any land charge created after 19 August 2008 as security for payment obligations will need to be terminated by the land charge creditor in order for the land charge amount to become due and payable and therefore enforceable. The required notice period is six months. The land charge amount therefore falls due on the expiry of six months after the termination has been declared.

The land charge is only legal, valid and enforceable once the registration has been completed and, in the case of a certificated land charge (*Briefgrundschuld*), the land registry has issued a certificate. For registration purposes, the signatures to the agreement need to be publicly certified (*öffentlich beglaubigt*). Customarily, the agreement is combined with an abstract acknowledgement of debt (*abstraktes Schuldanerkenntnis*) of the debtor and submission to immediate enforcement (*Unterwerfung unter die sofortige Zwangsvollstreckung*). This enables the bank, in an enforcement scenario, to seize the debtor's assets without much delay and to enter into discussions or legal proceedings regarding potential defenses of the debtor mainly after seizure. The submission to immediate enforcement needs to be notarized (*beurkundet*).



Taking security over real estate is costly and the fees depend on the amount of the land charge and whether it includes a submission to immediate enforcement (Unterwerfung unter die sofortige Zwangsvollstreckung).

The registration of a land charge is an administrative process that may take, depending on the competent land registry, some weeks or even several months

Guarantee/Surety

In Germany the suretyship and the guarantee are the most common kinds of personal security.

Suretyship

Under a suretyship the surety undertakes to assume responsibility for the obligation(s) of a debtor if that debtor defaults. Due to it being an accessory right, the suretyship is used very rarely to secure third party obligations in Germany.

Guarantee

In contrast to a suretyship, a guarantee is of a non-accessory nature. By giving a guarantee, the guarantor guarantees to a creditor the proper and punctual observance and performance of the obligations of the debtor. The guarantor also usually agrees to assume responsibility up to a certain amount and to pay that amount under certain circumstances to the lender on its prior written demand, if the obligor fails to pay the secured obligations. Because the liability of the guarantor can be limited in the guarantee and it is a non-accessory security, the guarantee is used more often than a suretyship to secure repayment claims.

A guarantee on first demand (which is the same as a suretyship on first demand) will only be callable if granted by a bank, another kind of financial institution, insurance company or otherwise by a company experienced with this type of guarantee.

Security assignment

A security assignment is a non-accessory security which can cover all present, future, actual and contingent receivables owing by debtors, suppliers and banks and includes insurance proceeds, indemnity claims, claims arising from any current or future account balance, intercompany claims and/or any claim arising from or in connection with guarantees and warranties granted to the debtor by a third party. In general, the assigned receivables do not only secure the redemption claims but all obligations owed by any assignor to a creditor, whether present or future, actual or contingent.

The perfection of the security assignment does not require the prior consent of the third party debtor. However, due to provisions in the security assignment agreement the assignor is often required to inform the respective third party debtors of the assignment within two or more business days. If an event of default occurs the assignee is normally entitled to collect the sums directly in its own name and for its account from the respective debtors.

Security transfer

In a security transfer agreement (non-accessory security) the transferor generally transfers to the transferee all his/her present or future ownership, co-ownership and expectant rights in respect of his/her current and future assets, which are or will be located from time to time within the designated security area.

For the perfection of the security transfer agreement no notification to third parties is required and the transferred assets need not be handed over to the transferee. However, due to the requirements set out in section 930 of the Civil Code perfection of the security transfer agreement nevertheless requires the transferor to undertake that he/she will hold all present and future assets which are or will be located in the designated security area, in the name and for the account of the transferee (*Besitzmittlungsverhältnis*).



Account pledge

A pledge over bank accounts (accessory security) is another typical security in banking transactions in Germany. The pledgor pledges its present and future rights and claims (whether conditional or unconditional) arising against the account-holding bank. The pledge is created by simple agreement and will not be effective unless the relevant account bank has been notified of the pledge. Often the parties agree that the pledgor is allowed to make withdrawals from the account in the ordinary course of business at any time before an event of default or a payment default under the secured facility occurs.

An account pledge gives the pledgee the right to seek to enforce after an event of default has occurred and in relation to which an acceleration notice has been given.

4. How long, following acquisition of a foreign target company, would it usually take in Germany for a German subsidiary of that foreign target company to grant a guarantee/security?

There is generally no restriction on when a German subsidiary can grant security (including a guarantee) following the acquisition of a foreign target company. Therefore, German subsidiaries may provide security immediately on completion of the acquisition.

To ascertain the authority of a local subsidiary to grant security, the German company's articles of association should be reviewed. Often, the granting of security requires the shareholder's consent.

5. Are there any restrictions on foreign banks lending to companies in Germany? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

Anyone wishing to conduct banking business or to provide financial services in Germany commercially or on a scale that requires a

commercially organized business undertaking requires a written license.

Banking business is defined conclusively in section 1 (1) of the German Banking Act (*Kreditwesengesetz*) (**Banking Act**) by a list of 12 types of businesses that are deemed to constitute banking business. These include the acceptance of funds (deposit business), granting loans (lending business) and the purchase and sale of financial instruments (principal broking services).

The decisive factor when assessing the licensing requirements is generally the manner in which the negotiations relating to the loan have been initiated. If the foreign entity specifically targets the market in Germany for the purpose of offering loan agreements repeatedly on a commercial basis to companies and/or persons that have registered offices or ordinary residence in Germany, this generally constitutes lending activities requiring a license (section 1 (1) sentence 2 no. 1 of the Banking Act). It is not clear to what extent involving or relying on affiliated companies' marketing activities can be deemed to be marketing activities of a foreign bank. However, it is frequently seen in the market that a German licensed entity markets and/or arranges financing, while the booking is done through a facility office not being licensed in Germany.

If the foreign institution solicits clients in Germany to offer loans repeatedly and on a commercial basis, the license requirement is triggered. Participating in a syndicated facility, however, does generally not trigger any licensing requirements.

Withholding tax

Generally no withholding tax applies in Germany except for financing secured by German real estate where the repayment is linked to profit.



6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Germany, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

In Germany, as in many other countries, the acquisition of a listed entity, a so-called "public takeover," is regulated. Unlike the acquisition of a private enterprise, a public takeover is not merely a matter of negotiations between buyer and seller. The regulatory regime provided by the German Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz or $Wp\ddot{U}G$) (Takeover Act) must be observed.

Practically all potential German targets for public takeovers are organized as stock corporations (Aktiengesellschaft). There are very few listed German companies that are organized in the legal form of a "partnership limited by shares" (Kommanditgesellschaft auf Aktien). A potential bidder should be aware of several typical "features" of a German stock corporation very early in the process.

Another important aspect that a foreign bidder should keep in mind, are the German rules on employee co-determination. The members of the supervisory board are, in general, elected at a meeting of the shareholders. However, under German co-determination law, the supervisory boards of German companies which on average employ 500 or more employees consist not only of members elected by the shareholders but also of employee representatives. If the company has on average (over a 17- to 20-month period) more than 500 employees and fewer than 2,000 employees located in Germany (the latter figure is calculated on a consolidated basis), one-third of the supervisory board members must be employee representatives. If the company has on average more than 2,000 employees in Germany, calculated on a consolidated basis, their representatives must make up half of the supervisory board. In the latter case, the chairman of the supervisory board (who is always elected by the shareholders) has a casting vote in case of a tie

The main principles of the German Takeover Act are:

- (a) equal treatment of all shareholders;
- (b) sufficient information, and sufficient time, for the shareholders to consider the offer and make an informed decision;
- (c) the management board and the supervisory board of the company which is the subject of the offer (**Target Company**) have to act in the best interest of the Target Company;
- (d) the person or legal entity making the offer (**Bidder**) and the Target Company must execute the offer expeditiously; and
- (e) avoidance of market disruptions in the trading of the shares of the Target Company.

The Takeover Act is accompanied by several statutory instruments, including the Ordinance on the Contents of the Offer Document, which set out more detailed requirements regarding the contents of the offer document and the consideration offered to the Target Company's shareholders.

The Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, the **BaFin**) supervises compliance with the Takeover Act.

Information regarding current and past offers may be found on the website of the BaFin (www.bafin.de).

The Takeover Act distinguishes between the following three types of offers:

- (a) "Regular Offers";
- (b) "Takeover Offers"; and
- (c) "Mandatory Offers".



Regular Offers fall under a more liberal legal regime, while Mandatory Offers are subject to the strictest level of regulation.

The main difference between the three types of offers relates to the principle of "acquisition of control". For the purpose of the Takeover Act, "acquisition of control" occurs if a Bidder acquires at least 30% of the voting rights in a Target Company (**Control**). For the purposes of determining whether Control has been acquired, extensive attribution rules apply.

In a Regular Offer, the acquisition of Control is not intended and does not occur. The Bidder makes an offer to acquire a stake below 30% or already has Control and merely increases his/her stake. In a Takeover Offer, the acquisition of Control is the goal of the offer, i.e. the Bidder intends to acquire Control through, or in conjunction with, the offer. In a Mandatory Offer, the acquisition of Control precedes the offer and triggers an obligation to make the Mandatory Offer.

In principle, the Bidder can choose whether he or she would like to acquire the securities of the Target Company against cash (Cash Offer) and/or against shares. However, the Bidder has to make a Cash Offer if he/she has purchased 5% or more of the Target Company's shares for cash within a period starting six months before the publication of the offer decision and ending at the end of the period known as the "Acceptance Period".

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

In German insolvency law there are the following types of creditors set out below:

(a) preferential creditors (*Massegläubiger*) – insolvency administrator and insolvency court, contracting parties for claims arising from contracts entered into with the insolvency administrator or preinsolvency contracts which the insolvency administrator elects to

perform, social plan creditors, actions based on claims for unjust enrichment;

- (b) secured creditors (*Aussonderungsberechtigte und absonderungsberechtigte Gläubiger*) creditors with security over real estate, creditors holding a lien over an asset which is part of the insolvency estate, creditors with security over tangible movable assets, creditors with security over rights and receivables, creditors holding a right of retention, federal, state and municipal governments with respect to certain claims (e.g., customs duty), legal proprietors, retention of title (*Eigentumsvorbehalt*) creditors, a restricted beneficiary *in rem*, a possessor, the holder of a contractual claim for restitution;
- (c) unsecured creditors (*Insolvenzgläubiger*) creditors holding a claim against the debtor at the time insolvency proceedings were opened, such as bond holders, unsecured loan note holders or unsecured contractual parties; and
- (d) subordinated creditors (*Nachrangige Gläubiger*) either pursuant to a contractual agreement or by law, because it constitutes a shareholder loan

Preferential claims

Preferential claims against the insolvency estate are satisfied in priority to the claims of other secured and unsecured creditors and can be enforced by legal action against the insolvency estate. As a general rule, these claims are paid on an undiscounted basis and directly from the insolvency estate.

Secured creditors

Secured creditors may, depending on the nature of their security right, have a direct claim against the insolvency estate for surrender of collateral or payment of the proceeds resulting from the enforcement of a security by the administrator (after deduction of certain fees), a so-called right to separate satisfaction (*Absonderungsrecht*). To the



extent the security is not sufficient to cover the total amount of the secured claim, the remaining claim will in principle be treated as an unsecured insolvency claim. To improve their chances to enforce their claim and enforce the security successfully, secured creditors sometimes enter into so-called "pooling agreements" which can reduce complexity and can sometimes improve their leverage in negotiations with the administrator.

Segregation right

A creditor with a segregation right (Aussonderungsrecht) is a creditor who holds a right in rem or a right in personam and can prove that an asset is no part of the insolvency estate because of that right. A segregation right is based on an asset not being part of the insolvency estate and therefore not part of those assets that can be accessed or confiscated by the insolvency administrator.

Unsecured creditors

Unsecured creditors must file their non-preferential insolvency claims (*Insolvenzforderungen*) for registration in the insolvency schedule to receive (partial) payment, if any. The administrator either rejects the filed claim or registers it in the insolvency schedule. In the case of a rejection, which can be due to insolvency specific reasons such as a claw back right or due to general principles, the creditor can bring a legal action to enforce acceptance.

Accepted insolvency claims entitle unsecured creditors only to a collective, equal and non-discriminatory satisfaction of their claim on a pro rata basis in accordance with the insolvency quota. The insolvency quota is determined by the insolvency administrator (under supervision by the court and the creditors' meeting and committee) at the end of the insolvency proceedings. It is calculated by dividing proportionately the distributable assets of the insolvency estate (in essence the proceeds from the liquidation of all assets after deduction of all preferential claims, all security interests to the extent paid off or settled and the cost of the proceedings including court fees and the

administrator's fees), among the total amount of accepted and unsecured insolvency claims.

General

Certain claims are subordinated and rank even lower than unsecured claims. This affects, inter alia, claims for repayment of shareholder loans and similar transactions. Exceptions can apply for loans granted by certain minority shareholders as well as for lenders who have become shareholders during the company's crisis for restructuring purposes. Subordinated claims will only be settled in the rare case that all higher-ranking claims have been entirely satisfied.

Creditors with reservation of title (*Eigentumsvorbehalt*) do not participate in the insolvency procedure. They will usually recover their assets or be paid in full.

Creditors with a lien on real estate can force the sale of the real estate or claim rental income. The result of a forced sale is often considerably lower compared to a going-concern sale. In most cases the creditor and the administrator will reach an agreement allowing the transaction to proceed without having to go through a forced sale.

In most cases secured creditors will be landlords, vendors and banks. Landlords will have statutory liens. Vendors will make use of retention of title clauses that allow them to retain title until their claim has been paid in full. They also receive an assignment on goods manufactured by making use of the delivered article and an assignment of the claim generated by the sale of the delivered article. Banks will usually have liens on land and also assignments over plant and equipment, inventory and account receivables.

Lenders, such as banks, usually play a very active part in the insolvency procedures, but this is often not the case with suppliers. If there are any, trade credit insurers will represent the vendors. In some cases, however, suppliers organize themselves into groups.



8. Is interest on debt incurred to acquire a company in Germany deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Deduction of interest

The provisions introduced under the interest barrier and the limitations in using loss carry forwards were implemented in the Act reforming business taxes 2008 (Unternehmenssteuerreformgesetz 2008). The "interest barrier" is the threshold below which companies are allowed to deduct interest on business expenses. The relevant provisions were introduced to avoid income generated in Germany being taxed outside of Germany. Previously businesses were often forced to pay taxes when in fact no profits were earned. Under the interest barrier the deductibility of net interest payable is limited to 30% of the EBITDA as determined for tax purposes. It is obvious that a business running at a financial accounting loss can, because of the add-back of net interest to its taxable result, end up paying tax because of its non-deductible net interest payable. The resulting tax is not paid out of earnings, but instead out of substance

The threshold for net interest payable up to which the interest barrier does not apply is currently EUR 3 million. This is not an exempt amount, but a threshold. Accordingly, once the net interest payable reaches the EUR 3 million cap, all interest payable will be exposed to the interest barrier deduction limitation. The threshold of EUR 3 million will protect, assuming an interest rate of 3%, a financing volume of up to EUR 100 million.

Therefore, it is worth considering whether to structure investment, whenever possible, through separate entities to multiply the benefit of the threshold by using several entities.

The interest barrier does not apply in a situation where the German group company can show that its debt to equity financing ratio is in line with the debt-to-equity financing ratio of its global group (known as an "escape clause"). In the past, the debt-to-equity ratio of the

German group company was permitted to deviate by up to 1% from the debt-to-equity financing ratio of its global group. This 1% tolerance margin has now been expanded to 2%.

Since German trade and industry traditionally has a high debt leverage (partly because of the less than fully developed German capital market) the likelihood of global groups having a debt-to-equity ratio, which is worse than or equal to the debt-to-equity ratio of the German group company is usually remote. Nonetheless, there may be opportunities where this "escape clause" can be used.

Carry forward of unutilized EBITDA

Whereas the net interest, which is disallowed as a deductible, can be carried forward much like a loss carry forward and under the same rules, a similar facility did originally not exist for excess taxable EBITDA, that is to say a taxable EBITDA volume, which was in excess of what was needed in order to shelter the net interest expense.

The rules regarding loss carry forwards provide for exactly this type of carry forward with the result that unutilized taxable EBITDA can be carried forward for use during the next five fiscal years.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Germany?

In Germany the concept of freedom of contract is recognized unless a provision of a contract is prohibited by mandatory law. Therefore, contractual subordination will generally be honored by a liquidator or bankruptcy trustee.

A claim that has been contractually subordinated by agreement will fall within the relevant group of subordinated claims and will, within that group, have the rank that has been contractually agreed.

Contractual subordination can be rescinded at any time before (but not after) commencement of any insolvency proceedings.



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Hong Kong

1. Is there any prohibition on a company incorporated in Hong Kong providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Under the Companies Ordinance (Chapter 622 of the Laws of Hong Kong) (**CO**), there are certain prohibitions on a company, private or public, incorporated in Hong Kong providing financial assistance in connection with the acquisition of shares in itself or its parent company.

Prohibition

Section 275 of the CO generally prohibits a company incorporated in Hong Kong from giving financial assistance directly or indirectly for the purpose of acquiring shares in that company or its holding company or for the purpose of reducing or discharging liabilities so incurred. Financial assistance includes assistance given by way of guarantee, security, indemnity, loan, novation or other similar agreement, gift or any other assistance by which the company's net assets are reduced to a material extent.

Section 275 of the CO applies only to financial assistance given by the target or by any of its subsidiaries. Therefore, the prohibition does not apply where the assistance is given by a parent in respect of an acquisition of its subsidiary's shares or by a subsidiary to assist in the acquisition of its sister subsidiary's shares. Also, the prohibition applies only to financial assistance given by a Hong Kong subsidiary for the acquisition of shares in its Hong Kong holding company. It generally does not restrict a Hong Kong subsidiary from giving financial assistance for the purpose of acquiring shares in its offshore-incorporated holding company.



In terms of timing, Section 275 applies to financial assistance given either.

- (a) before or at the same time as the acquisition; or
- (b) to reduce or discharge a liability incurred for the purpose of (i.e., after) the acquisition.

Exceptions

The CO provides that certain specified transactions will not constitute unlawful financial assistance (Sections 277 to 281). They are:

- (a) where the company's principal purpose in giving the assistance is not for the purpose of any acquisition or reducing any relevant liability, or even if the principal purpose of the giving of the assistance was for any acquisition or reducing any relevant liability, it was an "incidental part of some larger purpose" and the assistance is given in good faith in the interests of the company;
- (b) a distribution by way of dividend lawfully made;
- (c) a distribution made in the course of a company's winding up;
- (d) an allotment of bonus shares;
- (e) a reduction of capital in accordance with Division 3 of the CO;
- (f) a redemption or purchase of shares made in accordance with Division 4 of the CO:
- (g) anything done in accordance with a court order under Division 4 of the CO:
- (h) certain arrangements made under section 237 or section 254 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Chapter 32 of the Laws of Hong Kong) (CWMPO);

- (i) the lending of money by the company in the ordinary course of its business where the lending of money is part of the ordinary course of business of the company;
- (j) the provision of financial assistance for the purposes of an employee's share option scheme; and
- (k) loans to employees (other than directors) to purchase shares.

Some of the exceptions apply to a listed company only if the company has net assets that are not reduced by the giving of the financial assistance or to the extent those assets are reduced, the assistance is provided by a payment out of distributable profits.

In practice, the most useful exception in the above list is the "lawful dividend" exception, which enables a purchaser to use funds in the target to assist the purchaser to finance the acquisition to the extent those funds can be extracted as a dividend paid by the target. That dividend would have to comply with the rules governing the payment of dividends under the CO, and also with the company's articles of association

Authorization procedures - General

The general prohibition on the giving of financial assistance can be relaxed on compliance with certain prescribed formalities, commonly known as "whitewash" procedures.

The new authorization procedures introduced by the CO allow all companies (both public and private) to give financial assistance for the purchase of their shares subject to the satisfaction of the solvency test (Sections 205 and 206 of the CO) and the obtaining of the relevant approvals as described below.



Solvency Statement

The CO requires the company to prove compliance with the "solvency" test: a statement (which is not required to be in any specified form) (**Solvency Statement**). The Solvency Statement must be completed and signed by a majority of the directors of the company voting in favor of giving the financial assistance.

The Solvency Statement provides that the directors have formed an opinion regarding the company's initial situation immediately following the date on which the assistance is proposed to be given, that there will be no grounds on which the company could then be found to be unable to pay its debts, and either:

- (a) if it is intended to commence winding up within 12 months of that date, that the company will be able to pay its debts in full within 12 months of the commencement of the winding up; or
- (b) in any other case, that the company will be able to pay its debts as they fall due during the period of 12 months immediately following the giving of financial assistance.

A director, in the course of forming that opinion, must inquire into the company's state of affairs and prospects and take into account all the liabilities of the company (including contingent and prospective liabilities). The Solvency Statement must be delivered to the members within 15 days after it is signed.

Auditors' report

Hong Kong law does not require a report to be produced by auditors to the directors of the company giving financial assistance. In practice, however, it is advisable that an auditors' report be obtained, as it would:

(a) constitute independent advice given to both the lenders and directors; and

(b) help the lenders in an acquisition finance transaction in their assessment of whether the company would pass the net solvency test.

Authorization procedures – Details

The three relevant authorization procedures are:

- (a) approval of the board of directors where the aggregate amount of financial assistance does not exceed 5% of the company's paid-up share capital and reserves (Section 283 of the CO);
- (b) approval of the board of directors together with approval of all of the members by written resolution (Section 284 of the CO); or
- (c) approval of the board of directors together with approval of the members by ordinary resolution (Section 285 of the CO), subject to the right of members holding at least 5% voting rights of the company to petition to the court for a restraining order (Section 286 of the CO).

The above procedures are, among other things, subject to the following conditions:

- (i) resolutions of the directors of the company which proposes to give financial assistance are passed before the assistance is given, resolving that the company should give assistance and that the giving of the assistance is in the best interests of the company and the terms and conditions under which the assistance is to be given are fair and reasonable to the company (and the grounds for those conclusions should be set out in full) but in the case of paragraph (c) above, the resolutions should also resolve that the giving of the assistance benefits those members of the company not receiving the assistance;
- (ii) on the same day that the directors pass the resolutions, the directors who vote in favor of it make a Solvency Statement that each of the directors making it has formed the opinion that the



- company satisfies the solvency test in relation to the financial assistance;
- (iii) in the case of paragraphs (a) and (c) above, a copy of the Solvency Statement and a notice must be sent to each member of the company (except that the notice is required to be sent at least 14 days before the day on which the ordinary resolution is proposed) and the information required to be provided in the notice is set out in Section 283(4) and Section 285(1)(c) of the CO respectively;
- (iv) in relation to paragraphs (a) and (b) above, the assistance is given not more than 12 months after the day on which the Solvency Statement is made; and
- (v) in relation to paragraph (c) above, the assistance is given not less than 28 days after the day on which the ordinary resolution is passed and not more than 12 months after the day on which the Solvency Statement is made.

Criminal and Civil Liability

If a company contravenes the prohibitions set out in Section 275 of the CO, the company and every responsible person of the company commit an offense and each is liable to a fine of HKD 150,000 and to imprisonment for 12 months.

The CO specifically provides that financial assistance in contravention of the provisions under the CO will not be rendered invalid and any contract or transaction connected with it is not affected only because of the contravention (Section 276 of the CO).

2. What are the implications under the corporate benefit laws of Hong Kong for a company incorporated in Hong Kong to provide financial assistance?

Commercial Benefit

In Hong Kong, directors of a company have a common law duty to act in the best interest of the company, and to exercise powers and take actions that will benefit the company commercially. In addition, the Companies Registry of Hong Kong (Companies Registry) has also issued non-statutory guidelines that outline the general principles for a director in the performance of his/her functions and exercise of his/her powers, which embody the requirement that the directors should act in the best interest of the company.

When considering providing financial assistance for the acquisition of the company's shares or shares in its holding company, directors must decide whether there is any commercial benefit to the company in providing that assistance. The leading authority on the issue of "commercial benefit" is the English Court of Appeal decision in *Rolled Steel Products (Holdings) Limited v. British Steel Corporation* ([1985] 2WLR 908), which courts in Hong Kong are likely to follow in determining the circumstances in which a local company can give a guarantee or grant security.

As discussed above, when considering providing financial assistance for the acquisition of the company's shares or shares in its holding company, directors must consider (and resolve) whether:

- (a) the company should give the assistance;
- (b) giving the assistance is in the best interests of the company and (in the case where an ordinary resolution is to be passed) will benefit those members not receiving the assistance; and
- (c) the terms and conditions under which the assistance is to be given are fair and reasonable to the company and (in the case where an



ordinary resolution is to be passed) to those members not receiving the assistance (Sections 283 to 285 of the CO).

In addition, directors also owe a duty to the company to exercise reasonable care, skill and diligence (Section 465 of the CO).

Relevant law

Having taken into account that decision and the *de facto* abolition of the *ultra vires* doctrine in 1997, the relevant law in Hong Kong appears to be as follows:

- (a) if the company's articles of association have an objects clause (with few exceptions, Hong Kong companies are now no longer required to have an objects clause in their articles of association) and it does anything which it is not authorized to do by its articles, then that act is not automatically invalid by reason only that it is not authorized by its articles (although it appears that that act may be rendered void on other grounds, where applicable). Under section 118 of the CO, a transaction is voidable if the parties to the transaction include a director of the company or its holding company or an entity connected with that director. However, a member of the company may bring proceedings to restrain the company from doing an act that is in breach of its stated objects;
- (b) where a company's articles of association have an objects clause, which does not allow the company to give a guarantee or grant security, there is a risk that a guarantee given or security granted will be challenged. Therefore, the company's articles of association should be reviewed to ensure that the company is allowed to give a guarantee and grant security. If an amendment to the articles of association of the company is necessary, the amendment can be made by the shareholders by way of special resolution and notice of that amendment in a specified form (together with a copy of the reprinted articles as amended) should be filed with the Companies Registry;

- (c) if the company's memorandum of association contains an express authority to give a guarantee or grant security, it is a question of construction in each case as to whether the express authority to give a guarantee or grant security is an "independent object" or a "mere power" ancillary to the main objects. Any "power" should be exercised for purposes reasonably incidental to the "objects" of the company;
- (d) directors have a general duty to act bona fide for the benefit of the company in exercising their powers. One factor that will be taken into account in determining whether the directors are exercising their powers properly is whether the guarantee or security is for the commercial benefit of the company. While commercial benefit is a factual matter in each case, the practical steps that could be taken to reduce the risk of commercial benefit arguments being successfully raised by the most likely objectors (the company's shareholders and creditors) are:
 - (i) obtaining the unanimous approval of the company's shareholders to the giving of the guarantee or the granting of security (see Sections 284 and 285 of the CO under the authorization procedure, the members of the company must pass a written resolution or an ordinary resolution approving the giving of the financial assistance); and
 - (ii) obtaining a statement from the company's directors that the company will not be unable to pay its debts as a result of giving the guarantee or granting security (under Section 205 of the CO, the directors are required to give the Solvency Statement in which they form the opinion that there will be no grounds that the company will be unable to pay its debts on the company's giving financial assistance); and
- (e) if the authority to give a guarantee or grant security is an independent object (as may be the case for banks and financial institutions), it appears that the issue as discussed in paragraph (b) above would be less significant, but this is not certain. The



question will need to be considered with reference to the actual business that the company carries on.

Group Benefit

Further, Hong Kong law generally does not recognize the concept of group benefit. When a parent company gives a guarantee or grants security in respect of a subsidiary's obligations, the commercial benefit to the parent can be clearly established. However, when a subsidiary company gives a guarantee or grants security in respect of its parent's obligations, it is often more difficult to establish what the commercial benefit is to the subsidiary.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Types of security

The typical types of security taken in finance transactions over shares and assets in Hong Kong include:

- (a) for shares, legal or equitable share mortgages;
- (b) for immovable assets, a debenture incorporating fixed charges (which could include a charge over cash in a bank account or an assignment over monies receivable) and floating charges; and
- (c) for land, a legal charge over the property.

Technical requirements

There are no notarization requirements in respect of security, guarantee, subordination or inter-creditor documents in Hong Kong (Security Documents).

Where a Security Document contains provisions giving rise to registrable charge, such Security Document must be registered with the Companies Registry within one month of creation of the relevant charge. Failure to register will affect the enforceability of that charge on the company's liquidation in Hong Kong and the priority of that charge. This registration requirement only applies to companies incorporated in Hong Kong and foreign companies which are registered as a non-Hong Kong company under Part 16 of the CO.

Charges over real property must also be registered with the Land Registry of Hong Kong to preserve their priority.

Apart from the registrations referred above, there may be different registration requirements in respect of certain types of assets (e.g., vessels, intellectual property) and in relation to different types of security providers (e.g., individuals).

Taxes and duties

No stamp duty or registration or similar taxes or charges are payable under the laws of Hong Kong in respect of security documents, except that:

- (a) if the shares in a Hong Kong company are mortgaged, a nominal stamp duty of HKD 5 is payable on the instrument of transfer signed in blank (which is normally required by the lender) being executed and the shares being registered in the name of the lender (or its nominee) to convert an equitable share mortgage into a legal share mortgage. Stamp duty at a rate of 0.2% of the value of shares being transferred will be payable on the actual enforcement of the security constituted by the share mortgage;
- (b) for a company granting a legal charge, a land registration fee of HKD 450 is payable to the Land Registry of Hong Kong; and
- (c) for a Hong Kong company or a company registered under Part 16 of the CO, a registration fee of HKD 340 is payable for the



registration of each security document registered at the Companies Registry.

(The relevant provisions governing the registration of a non-Hong Kong company in Hong Kong are set out in Part 16 (Division 2) of the CO (Sections 776 and 777 of the CO).)

4. How long, following acquisition of a foreign target company, would it usually take in Hong Kong for a Hong Kong subsidiary of that foreign target company to grant a guarantee/security?

There is generally no restriction on when a local subsidiary can grant a guarantee or security following the acquisition of a foreign target company. The prohibition set out in Section 275 of the CO does not apply to the giving of financial assistance by a company for the purpose of the acquisition of a share in its holding company if that holding company is incorporated outside Hong Kong.

However, if there are financial assistance issues and the Hong Kong subsidiary is required to undergo the authorization procedure, the period in which the subsidiary can provide the guarantee or security depends on the type of authorization procedures adopted by the Hong Kong subsidiary. Section 283 is more relevant where only a small amount of financial assistance is involved. Therefore, the authorization procedures provided under Section 284 or Section 285 will be more commonly used in practice.

If approval of all the members can be obtained (Section 284), the quickest period in which the company can provide the guarantee or security is at least 14 days from the acquisition. The period of 14 days is determined by the adjudication of stamp duty on the share purchase by the Stamp Office. (Only after payment of stamp duty can the register of members be updated for new members to approve the giving of guarantee or security.)

If approval of all the members cannot be obtained and the company has to rely on the passing of an ordinary resolution for the giving of a guarantee or security (Section 285), unless the ordinary resolution is to be passed by existing shareholders (in which case the giving of a guarantee or security can take place simultaneously with or immediately after the acquisition but in any event at least 28 days after the date of the passing of an ordinary resolution by existing shareholders), the period in which the company can provide the guarantee or security can be up to 56 days (if the ordinary resolution is to be passed by existing and new shareholders). The period of 56 days is calculated in light of:

- (a) the period of 14 days for the adjudication of stamp duty on the share purchase by the Stamp Office:
- (b) the fact that the notice and solvency statement is required to be circulated to members at least 14 days before the passing of ordinary resolution; and
- (c) the requirement that the giving of the guarantee or security can only take place at least 28 days after the passing of the ordinary resolution

The financial assistance can be provided within 12 months after the date of the Solvency Statement (and will only be given after members' approval is obtained or an ordinary resolution is passed, as the case may be).

However, in practice, it is often not just the company granting the financial assistance that has to carry out authorization procedures. If the shares acquired or to be acquired are shares in the holding company of the Hong Kong company, the holding company and any intermediate holding company must also carry out the authorization procedures if that holding company or intermediate holding company is also incorporated in Hong Kong and intends to provide security or a guarantee in relation to the share acquisition. This will therefore delay



the date when the Hong Kong company can grant the guarantee or security.

5. Are there any restrictions on foreign banks lending to companies in Hong Kong? Are interest payments to foreign banks typically subject to withholding tax?

Lending regulation

A foreign bank or financial institution lending to a company located in Hong Kong is not subject to any licensing requirements or other regulatory restrictions if the lender is an "authorized institution" (AI) under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong).

There are also currently no regulatory controls over the movement of foreign exchange.

However, a lender to a Hong Kong company, which is not an AI, should be aware of the Money Lenders Ordinance (Chapter 163 of the Laws of Hong Kong) (**Money Lenders Ordinance**). The Money Lenders Ordinance imposes licensing and other compliance requirements that may apply to a non-AI lender unless:

- (a) the lender falls under one of the categories of "exempted person" that are set out in the Money Lenders Ordinance; or
- (b) the loan falls under one of the "exempted loan" categories listed in the Money Lenders Ordinance.

It is not possible to contract out of the Money Lenders Ordinance.

"Exempted persons" and lenders of "exempted loans" are exempted from the licensing requirements under the Money Lenders Ordinance and most of its other compliance requirements. They will, however, remain subject to the usury provisions of the Money Lenders Ordinance, which, in essence, regulate the charging of excessive interest rates by any person. Under Section 24 of the Money Lenders Ordinance, an effective annual interest rate of 60% is illegal. Also, under Section 25, an effective annual interest rate that is between 48% and 60% is presumed to be extortionate and a Hong Kong court may reopen the underlying transaction.

A lender to a Hong Kong entity should also be aware of the Partnership Ordinance (Chapter 38 of the Laws of Hong Kong) (Partnership Ordinance). According to the Partnership Ordinance, where a loan advance is made at an interest rate that varies with the borrower's profits or where repayment is made by way of a share of the borrower's profits, the lender will be treated as a partner of the borrower (and will be liable as such). In addition, a lender that advances money on these terms may be subordinated to the borrower's other creditors. It is common in Hong Kong for a lender and borrower to agree to contract out of the Partnership Ordinance.

No withholding

Interest, fees or commission payable by a company located in Hong Kong under a banking facility or a loan are not subject to any withholding tax in Hong Kong.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Hong Kong, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Takeovers Code

The Code on Takeovers and Mergers (**Takeovers Code**) issued by the Securities and Futures Commission of Hong Kong (**SFC**) applies to takeovers and mergers affecting public companies in Hong Kong and companies with a primary listing of their equity securities in Hong Kong. It imposes (among other things) certain disclosure obligations on the offeror and the offeree in a proposed takeover of a company



whose shares are listed on the Stock Exchange of Hong Kong Limited. Those disclosure obligations include the details of how the takeover is financed.

Disclosure requirement

Rule 3.5 of the Takeovers Code provides that a firm intention to make an offer should be made only when an offeror has "every reason to believe that it can and will continue to be able to implement the offer." The offeror's financial adviser is required to confirm in the announcement that "resources are available to the offeror sufficient to satisfy full acceptance of the offer" (**Relevant Statement**). The financial adviser is expected to observe the highest standard of care to satisfy itself of the adequacy of resources, including performing the required due diligence and making due enquiry. The SFC may require evidence in support of the Relevant Statement or that the offeror has sufficient resources to complete the purchase of shares, which gives rise to the offer. A similar statement is required in the offer document issued by the offeror in connection with the offer if the offer consists of, or includes, cash or other assets (other than new securities issued by the offeree company).

The offer document must also contain a description of how the offer is financed and the source of the finance (see paragraph 12(b) of Schedule I to the Takeovers Code), except for cash offers seeking to privatize the offeree company and without any waiver of the acceptance condition. The principal lenders or arrangers of that financing must be named. Where the offeror intends that the payment of interest on, repayment of, or security for, any liability (contingent or otherwise) will depend to any significant extent on the business of the offeree company, a description of the arrangements contemplated will be required. Where this is not the case, a negative statement to this effect must be made in the offer document. Further, except with the consent of the Executive, documents relating to the financing arrangements need to be made available for inspection and can be viewed on (among others) the SFC's website (see Notes 1(1) and 2 to Rule 8 of the Takeovers Code).

Many leveraged buyouts require members of the target group to give guarantees and security to the lenders. As a result of the requirements under paragraph 12(b) of Schedule I to the Takeovers Code, the terms and conditions of the security and guarantee arrangements, to the extent given or to be given by those members, should also be disclosed in the offer document.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Order in insolvent liquidation

Section 250 of the CWMPO provides for the general principle of *pari passu* distribution. This means that all debts and claims of the general creditors will rank equally among themselves and, if the property of the company is insufficient to meet them in full, they will be paid proportionately. However, Sections 256 and 265 of the CWMPO provide for situations where certain creditors will be paid ahead of other creditors.

In general, the order of ranking of creditors is:

- (a) creditors with security if there are no inter-creditor agreements and arrangements among the secured creditors to the contrary, earlier created charges take priority over later created charges (unless the later chargee had notice of the earlier charge) except that an earlier registered charge or mortgage over real property with the Land Registry in Hong Kong will take priority over a later registered charge or mortgage over the same property under the Land Registration Ordinance (Chapter 128 of the Laws of Hong Kong);
- (b) the expenses of the winding up, including the liquidator's remuneration (Section 256 of the CWMPO (for voluntary liquidation) and Rule 179 of the Companies Winding-up Rules (for compulsory liquidation));



- (c) preferential payments as specified in Section 265 of the CWMPO;
- (d) creditors with floating charges (Section 265(3B) of the CWMPO);
- (e) any preferential charge on goods distrained that arises under Section 265(5A) of the CWMPO;
- (f) the company's general unsecured creditors;
- (g) interest on debts in paragraphs (c) to (e) above (which rank equally) outstanding for the period after the company went into liquidation (Section 264A of the CWMPO);
- (h) any debts or other sums due from the company to its members as members (known as "deferred debts" under Section 170(1)(g) of the CWMPO); and
- (i) the members generally in accordance with their respective rights and interests (Section 250 of the CWMPO).

A new Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015 was gazetted in October 2015. The Government has proposed a number of changes to the existing provisions on corporate insolvency law, such as:

- (a) "transactions at an undervalue" provisions so as to enable the Court to set aside transactions at an undervalue entered into by a company prior to its winding up; and
- (b) (as modeled on the relevant provisions in the Insolvency Act 1986) new provisions to invalidate floating charges created in favor of persons connected with the insolvent company (e.g., a director) (as opposed to invalidating any floating charges created within 12 months prior to the commencement of the winding up of the company under the present provisions of the CWMPO).

8. Is interest on debt incurred to acquire a company in Hong Kong deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Interest is only deductible in Hong Kong if it is incurred for the purposes of producing assessable profits and meets one of a number of specified conditions. Interest paid on debt incurred for the purposes of acquiring shares (from which non-assessable dividend income will be derived) is not tax-deductible. On the other hand, share traders (e.g., some venture capital and private equity funds) which carry on business in Hong Kong should be allowed a tax deduction for interest used for acquiring shares on the basis that they will be taxable in Hong Kong on the Hong Kong sourced profits associated with the subsequent disposal.

It is purely a commercial decision for a lender as to whether it should lend to a thinly capitalized Hong Kong company. There are no thin capitalization restrictions for Hong Kong tax purposes.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Hong Kong?

Under a typical contractual subordination, the senior and subordinated creditors will agree that the subordinated creditor will not exercise its rights in respect of the relevant debt until the senior creditor has been paid in full.

Case law has confirmed the validity of contractual subordination arrangements in which a creditor agrees to waive, postpone or subordinate its debt on insolvency to the debts of other creditors. However, any arrangement that interferes with the rights of other creditors might be called into question on the liquidation of the company and would be ineffective if it would infringe the *pari passu* principle, since in the liquidation of a company, creditors (other than creditors having security or a statutory priority) will rank *pari passu* on the winding up of that company.



In deciding whether to honor any other subordination arrangements, a liquidator will, at a minimum, need to consider:

- (a) whether doing so would prejudice or adversely affect the rights of other creditors of that subordinated creditor who are not parties to the subordination arrangement (*Re Maxwell Communications Corp plc (No. 2)*, Re [1993] 1 W.L.R. 1402); and
- (b) the statutory set-off provision contained in Section 35 of the Bankruptcy Ordinance (Chapter 6 of the Laws of Hong Kong), as applied by Section 264 of the CWMPO.

Section 35 of the Bankruptcy Ordinance provides that if, before the company goes into liquidation, there have been mutual credits, mutual debts and other mutual dealings between the company and any creditor, an account will be taken of what is due from each party to the other in respect of the mutual dealings and the sums due from one party will be set off against the sums due from the other.

The rules of insolvency set-off under Section 35 of the Bankruptcy Ordinance are mandatory (*National Westminster Bank Ltd v. Halesowen Presswork and Assemblies Ltd* [1972] A.C. 785). Therefore, Section 35 poses a potential difficulty in the context of subordinated debt arrangements.

In a typical subordination agreement, the senior creditor will require the subordinated creditor not to exercise any rights of set-off that the subordinated creditor may have against the debtor, to ensure that part of the subordinated debt is not repaid before the senior debt is repaid. Since it is not possible to contract out of the statutory provisions, it is therefore common for subordination agreements to have a clause requiring the subordinated creditor to prove for the full amount of its claims in respect of its subordinated debt and then apply any amount paid to it, in respect of that subordinated debt, in satisfaction of the senior debt until the senior debt is repaid in full. Andrew Lockhart Baker & McKenzie Hong Kong Partner

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Hungary

 Is there any prohibition on a company incorporated in Hungary providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Hungarian law prohibits the giving financial assistance in relation to the acquisition of shares issued by a public company limited by shares (nyilvánosan működő részvénytársaság) except on certain conditions.

Under Section 3:227 (1) of the Act V of 2013 on the Civil Code (Civil Code):

"Public companies limited by shares shall be allowed to provide financial assistance to third parties for the acquisition of shares issued by the public limited company only

- (a) under market conditions;
- (b) from the assets available for the payment of dividends; and
- (c) provided that the general meeting approved such decision by at least a three-quarters majority upon recommendation by the management board."

Section 3:227 (2) of the Civil Code sets out in detail the rules that apply to the recommendation of the management board, i.e. the requirements of the "whitewash procedure" under Hungarian law. It states:

"The recommendation shall contain

- (a) the reasons for the financial assistance;
- (b) the risks involved;
- (c) the conditions; and

(d) the price of the shares; and the advantages the company is likely to gain by providing such financial assistance."

The above set of rules came into effect on 15 March 2014. They are applicable to a public company limited by shares if the company has amended its articles of association and recognized the corporate rules of the Civil Code as binding on it.

Because the rules have come into effect very recently, there is not yet an established court practice nor any relevant commentary or guidelines in relation to the application of the above financial assistance rules.

In relation to other types of companies, in particular the private company limited by shares (zártkörűen működő részvénytársaság) and the private company limited by quotas (korlátolt felelősségű társaság), we are not aware of any distinct rules in relation to the prohibiting or limiting the giving of financial assistance.

2. What are the implications under the corporate benefit laws of Hungary for a company providing financial assistance?

Hungarian law does not recognize the concept of corporate benefit in the common law sense. Nevertheless, under Section 3:112 (2) of the Civil Code:

"The executive officer shall manage the operations of the business association independently, based on the primacy of the business association's interests. In this capacity, the executive officer shall discharge his duties in due compliance with the relevant legislation, the instrument of constitution and the resolutions of the company's supreme body."

Therefore, the executive officers of any company must act in the best interests of that company. In limited circumstances, however, if there is an imminent threat to the business association's solvency, the



executive officers must take the creditor's interests into account. An imminent threat to the business association's solvency has occurred when the executive officers of the company were or should have been able to foresee that the business association will not be able to satisfy its liabilities when due. Under Section 3:118 of the Civil Code:

"In the event of a business association's dissolution without succession, creditors may bring action for damages up to their claims outstanding against the company's executive officers on the grounds of non-contractual liability, should the executive officer affected fail to take the creditors' interests into account in the event of an imminent threat to the business association's solvency. This provision is not applicable in the case where the company is wound up without going into liquidation."

Therefore the giving of financial assistance will be limited by it being able to be given, in the opinion of the management board, without making the company insolvent.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Securities over shares

Under the Civil Code, the following major types of securities may be established over shares.

Security deposit (*óvadék*)

The security deposit can be established:

- (a) as a possessory charge or by means of a tripartite agreement in relation to dematerialized shares; or
- (b) as a possessory charge in relation to paper form shares.

Under limited circumstances, the obligee under the security deposit may directly acquire ownership title in the shares encumbered by a security deposit under Section 5:138 (1) of the Civil Code.

Possessory charge (kézizálog)

This is effected by means of transfer of possession of the securities from the charger to the chargee.

Securities over assets other than shares

In relation to assets other than shares, the following two major types of security may be granted.

Fixed charge (jelzálog)

A fixed charge can be taken over various types of assets (not only over real estate but also over other assets such as vehicles, rights and claims).

To duly effect the establishment of a fixed charge, the charge must be registered in the relevant register under Section 5:93 (1) of the Civil Code.

Possessory charge

The possession of the encumbered asset must also be transferred from the charger to the chargee. The transfer of possession must be recorded in a formal arrangement, e.g., in company minutes or in an agreement.

Costs and fees

As a general rule, no tax or stamp duty is payable if one of the types of security referred to above is granted. However associated costs and fees may arise.



Registration

Registration fees are based on the registration proceeding in the relevant registry.

The calculation of the fee payable and its basis depends on the rules pertaining to the relevant registry. Nevertheless, in most cases, there is a flat fee, which is multiplied by the number of the assets to be encumbered

Notarization

Notarial fees will apply, if the charge agreement is incorporated into a notarial deed to effect direct enforceability under Act LIII of 1994 on the Judicial Enforcement.

The notarial fee to be paid depends on the type of documents to be notarized and on various other factors, including the transaction value.

4. How long, following acquisition of a foreign target company, would it usually take in Hungary for a Hungarian subsidiary of that foreign target company to grant a guarantee/security?

We are not aware of specific timing requirements in relation to the granting of a guarantee/security. Following the registration of the change of control by the competent registry court and due completion of the acquisition of the target company, the subsidiary is entitled to grant a guarantee or security.

5. Are there any restrictions on foreign banks lending to companies in Hungary? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

Under Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (**Credit Institutions Act**), offering loans and credit facilities within the territory of Hungary on a business requires a

license. The license is granted by the National Bank of Hungary, which is the competent financial supervisory authority (the Authority).

The Credit Institutions Act, however, sets out the following exceptions to the above rule:

- (a) in the case of a credit institution having a registered seat in a member state to the Organization for Economic Co-operation and Development (OECD), loans and credit facilities may be offered on a cross-border basis, if that credit institution obtained a license from the competent financial supervisory authority in the state of the registered seat. Under the Credit Institutions Act, the entity, which intends to offer loans and credit facilities on a cross-border basis, must notify the National Bank of Hungary about the intended services prior to the actual offerings; and
- (b) in the case of any other credit institution having a registered seat in another member state of the European Economic Area, loans and credit facilities may be offered on a cross-border basis.

Withholding tax

Generally, interest payments to foreign banks are not subject to withholding tax.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Hungary, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Under Act CXX of 2001 on Capital Markets (Capital Markets Act), there are two requirements that are intended to ensure that the bank debt is available when the deal closes. These are that:

(a) the takeover bid must be approved by the National Bank of Hungary; and



(b) the bidder must attach proof to its application for approval to certify that certain type of coverage is established as the purchase price for the shares intended to be acquired.

The coverage must be cash, government securities issued by any member state of the European Union or the OECD or a bank guarantee issued by a credit institution that is established in any member state of the European Union or the OECD.

Approval by the National Bank of Hungary

The rules set out below are only applicable to the acquisitions in public companies limited by shares (*nyilvánosan működő részvénytársaság*).

Under Section 69 (1) of the Capital Markets Act:

"The offeror and the investment service provider commissioned in accordance with Section 68 (4) shall submit the takeover bid to the National Bank of Hungary for approval; they shall simultaneously send the bid and the relevant documents to the management body or the board of directors of the offeree company and submit the takeover bid - as it is filed for approval - for publication."

The National Bank of Hungary must deliver its decision in relation to the takeover bid within 10 business day of its receipt.

If the bidder does not comply with the purchase price payment obligations stipulated in the takeover bid, it must pay late payment interest and, under Section 74 (8) of the Capital Markets Act, the National Bank of Hungary is entitled to impose certain measures against it. Section 78(4) states:

"If the contract is cancelled by the seller, the offeror shall so notify the Authority within two working days. Payment of the default penalty or cancelling the contract shall have no effect on the National Bank of Hungary's powers to impose the sanctions defined in this Act for any

violation of the regulations pertaining to payment of the consideration."

Certification by bidder

The bidder must certify under Section 69 (6) (b) of the Capital Markets Act that the offeror has sufficient funds available to cover the consideration payable for the shares to which the takeover bid relates.

Section 69 (7) of the Capital Markets Act provides three options, which may be considered as sufficient coverage for the payment obligations of the bidder under the takeover bid as follows:

- (a) cash;
- (b) government securities issued by any Member State of the European Union or the OECD; and
- (c) a bank guarantee issued by a credit institution that is established in any Member State of the European Union or the OECD.

The certification in relation to the available funds must be attached to the takeover bid to be submitted to the National Bank of Hungary. In practice, the term "sufficient coverage" requires that the coverage to be established is easily accessible and enforceable. In particular, in the case of cash, the establishment of a security deposit may be advisable.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Under Hungarian law, if insolvent liquidation (*felszámolási eljárás*) has been initiated against an enterprise, all of the debts and claims of that enterprise are assessed and enforced under the provisions of the Act XLIX of 1991 on the Bankruptcy and Liquidation Proceedings (**Insolvency Act**).



Section 57 (1) of the Insolvency Act determines the statutory sequence in relation to the payment of creditors' claims registered and enforced against the enterprise under liquidation (Insolvent Company). Usually the assets will not fully cover each and every claim. The ranking in Section 57 of the Insolvency Act indicates the priority of payments of the claims.

Under Section 57 (1) of the Insolvency Act generally claims are ranked in the following descending order of priority:

- (a) the costs of the liquidation;
- (b) the claims of the secured creditors;
- (c) certain other special claims (such as maintenance payments);
- (d) taxes and other public duties;
- (e) unsecured contractual receivables;
- (f) the claims of:
 - (i) any member (shareholder) of the Insolvent Company with majority control;
 - (ii) any executive officer of the Insolvent Company;
 - (iii) any executive employee of the Insolvent Company; and
 - (iv) an economic operator under the majority control of the Insolvent Company.

Based on the above statutory sequence under the Insolvency Act, the claims of the creditors (both secured and unsecured) have priority of payment over equity claims in relation to the Insolvent Company.

8. Is interest on debt incurred to acquire a company in Hungary deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Under Section 8 (1) (j) of the Act LXXXI of 1996 on Corporate and Dividend Tax, under certain conditions interest payable under a credit facility or a loan may decrease the pre-tax profit.

The pre-tax profit is increased by:

- (a) the interests shown under expenses or claimed as part of the cost of an asset during the tax year on the receivables (in particular under credit facilities and loans) (with the exception of receivables due from financial institutions); and
- (b) the sum shown as a deduction from the pre-tax profit according to transfer pricing rules, based on the receivables (in particular under credit facilities and loans) (with the exception of receivables due from financial institutions), in an amount proportionate to the part of such receivables, that is in excess of three times the amount of own equity.

This is the general rule for tax deduction in respect of interest payments and thin capitalization. The application of the detailed tax rules needs to be thoroughly analyzed in relation to each set of circumstances to have the full picture.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Hungary?

Under Hungarian law, as referred to in the answer to question 7, the insolvent liquidation of an enterprise is strictly regulated by the Insolvency Act. Therefore, whether contractual subordination will be recognized depends on the provisions of the Insolvency Act. We are not aware of any provisions in the Insolvency Act which would differentiate between claims registered and enforced against the



Insolvent Company on the basis of whether those claims are subordinated claims or not.

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Indonesia

 Is there any prohibition on a company incorporated in Indonesia providing financial assistance in connection with the acquisition of shares in itself company or its parent company (either direct or ultimate)?

Subject to the corporate benefit principle, there is no statutory prohibition on a company incorporated in Indonesia providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate). There are protection provisions for minority shareholders under Law No. 40 of 2007 on Limited Liability Companies (Indonesian Company Law) and Law No. 8 of 1995 on Capital Market (Indonesian Securities Law).

2. What are the implications under the corporate benefit laws of Indonesia for a company providing financial assistance?

The Indonesian Company Law requires that the business operations of a limited liability company be carried out in accordance with the company's objectives and purposes as specified in the company's articles of association

In our view, the capacity of a company to enter into an agreement is not limited to the language of the objectives and purposes clauses but will also include entering into an agreement that facilitates business opportunities or financing opportunities to achieve its business purposes and objectives. The court, based on factual circumstances, will determine the validity of this argument. Although not necessary, specific reference in the corporate approvals (such as in the board of commissioners' approval and the general meeting of shareholders' approval) may strengthen the evidence of corporate benefit. In relation to the duty of the directors, the Indonesian Company Law provides that each member of the board of directors must undertake his/her duties in good faith and with full responsibility for the interests and



business of the company. While the duty of good faith is not further elaborated on by the Indonesian Company Law, in practice, one of the principles that generally applies is the principle of "corporate benefit." In this regard, a director must act only in what he/she considers to be the best interests of the company.

To minimize any issues in relation to corporate benefit, boards of the company and its shareholders should pass resolutions to "whitewash" the corporate benefit issues. However, it should be noted that the Indonesian Company Law contains provisions on lifting the corporate veil. Under these provisions, a company's shareholder could be personally liable for:

- (a) any contract entered into on behalf of the company; and
- (b) for the company's losses in excess of the value of the shares that the shareholder has subscribed for if, among other things, the relevant shareholder:
 - (i) either directly or indirectly, has in bad faith misused the company solely for its own personal interests; or
 - (ii) both directly and indirectly, has used the company's assets unlawfully, causing the company's assets to become insufficient for the settlement of the company's liabilities.
- 3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The types of security typically granted over shares and assets under Indonesian laws are as follows:

- (a) for shares, a pledge over shares;
- (b) for other movable property, a pledge or fiducia security; and

(c) for immovable property, a mortgage (Hak Tanggungan).

Pledge

Pledges are governed under Article 1150-1160 of the Indonesian Civil Code (Civil Code). They are defined as a right obtained by a creditor over movable goods that are delivered by the debtor or a third party as security for the debtor's indebtedness. A pledge gives the creditor preferential rights over other creditors to satisfy the claims against the debtor out of the proceeds of the sale of the goods.

The establishment of a pledge depends on the nature of the goods. A pledge of tangible movable goods and bearer instruments is established by the delivery of the goods into the actual possession of the pledgee or a third party agreed on by the parties.

A pledge over shares is established by entering into a pledge agreement (which may be entered in English) and the pledge must be notified to, and annotated in the company's share register book.

Fiducia security

Fiducia security is a security right securing repayment of a debt over:

- (a) tangible or intangible movable goods; and
- (b) immovable goods which cannot be the subject of the Hak Tanggungan and are still in the possession of the grantor of the fiducia security.

This security right will grant the secured party priority rights over other creditors.

Law No.42 of 1999 on Fiducia Security requires a fiducia agreement to be executed in Bahasa Indonesia in the form of a notarial deed. The fiducia security will be established on registration of the fiducia security. Registration of fiducia security is done electronically by



filing an electronic application form to the online fiducia registration system provided by the Ministry of Law and Human Rights.

The appointed notary will assist in the online registration of the fiducia security. Upon the completion of all procedures of the online registration, an online Certificate of Fiducia Security will be produced by the online fiducia registration system and a print-out of such Certificate of Fiducia Security will be provided to the creditor.

Hak Tanggungan

A Hak Tanggungan is documented in a deed drawn in Bahasa Indonesia before a land deed official known as a Pejabat Pembuat Akta Tanah (**PPAT**) who, in most cases, is a public notary as well. The grantor of the Hak Tanggungan (being the legal owner of the land) and the security holder are the parties to this deed. The PPAT is obliged to register the Hak Tanggungan within seven days from the signing of the deed at the National Land Agency known as Badan Pertanahan Nasional (BPN). The Hak Tanggungan will be registered in the land book at BPN on the seventh day after BPN receives the complete application for its registration. A first priority security interest will be created on the date of registration by BPN.

Stamp duty

Under Indonesian taxation laws, stamp duty is imposed for certain types of documents. The nominal cost is IDR6,000 (approximately USD0.45) per document, regardless of the value of the transaction. Technically, in case the relevant document is executed outside Indonesia, stamp duty is due only at the time the document is used or submitted to the courts in Indonesia.

4. How long, following acquisition of a foreign target company, would it usually take in Indonesia for an Indonesian subsidiary of that foreign target company to grant a guarantee/security?

In order to ascertain the corporate authority of an Indonesian company to grant a guarantee or security, the company's articles of association should be reviewed. Generally, the articles of association require the directors to obtain prior written approval from the board of commissioners (and from the shareholders) of certain corporate actions involving granting of security or becoming a guarantor. The absence of proper corporate authority could render the agreement void.

Under Indonesian Company Law, it is mandatory that shareholders' approval is obtained for the transfer and encumbrance of assets of the company with a value of more than 50% of the company's net assets. A general meeting of shareholders must approve this corporate action with a quorum of at least three-quarters of the total number of issued shares with valid voting rights and the vote of three-quarters of the number of votes cast.

The Indonesian Company Law requires that, before convening a general meeting of shareholders, a notice to the shareholders must be delivered at least 16 days prior to the scheduled meeting date. However, this will not apply if the meeting is attended, and the resolutions are approved, by all shareholders.

If the company is a public company, there are certain procedural requirements to convene a shareholders' meeting. These include the requirement to announce the plan to convene a general meeting of shareholders at least 14 days prior to the notice of that meeting. As mentioned above, the notice of general meeting must be given by the company at least 16 days prior to the scheduled meeting date.



5. Are there any restrictions on foreign banks lending to companies in Indonesia? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

Currently, there are no restrictions on foreign banks lending to companies in Indonesia.

Interest payments and withholding tax

Interest payments to foreign banks (offshore entities) are typically subject to withholding tax.

The withholding tax rate on interest paid by a resident taxpayer to non-resident taxpayers (provided that the payment is not effectively connected with a permanent establishment that the recipient has in Indonesia) is 20%. This is a final withholding tax. However, if the interest is paid to a party that is a tax resident of a country with which Indonesia has a tax treaty in force, the withholding tax rate may be lower. Under most of the Indonesian tax treaties, the withholding tax rate on interest payment is reduced to 15%, 10% or 5%, depending on the applicable tax treaty. Generally, under some of the Indonesian tax treaties, the lower rate will be applicable only if the recipient is the beneficial owner of the interest.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Indonesia, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

A takeover of a publicly listed company is defined as an action directly or indirectly causing changes to the controller(s) of the company. The controller of a publicly listed company is defined as a party (or parties) that:

(a) owns more than 50% of the total issued and paid-up share capital; or

(b) has the ability to, directly or indirectly, determine, in whatever manner, the management and/or the policies of the target company.

Unless a takeover falls under the exemption, it must be followed by a tender offer for all the remaining shares.

Under The Financial Services Authority (*Otoritas Jasa Keuangan*, **OJK**) Rule No. 54 /POJK.04/2015 dated 29 January 2015 on Voluntary Tender Offer, any party that intends to make a tender offer must announce the plan in at least two Indonesian daily newspapers, one of which has nationwide circulation. The announcement must include, among other things, a statement by an independent accountant, bank or securities company, that the party has adequate funds to finance the tender offer.

If the acquisition is of an Indonesian bank, under the prevailing laws, a bank acquisition must not use any financing (in whatever form) from a bank or other parties in Indonesia.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Under Article 189 of Law No. 37/2004 on Bankruptcy and Suspension of Obligation for Payment of Debts (**Bankruptcy Law**), the curator must draw up a list for distribution for approval by the supervisory judge. The list for distribution contains details of receipts and expenditures, including compensation for the curator, names of creditors, the amount of each claim verified, and the portion to be received by creditors.

Basically, under the prevailing laws, the order of priority in an insolvent liquidation is as follows:

(a) claims given general priority rights under Article 1149 of the Civil Code, e.g., legal charges exclusively caused by auction and



- settlement of inheritance (the Civil Code states that these have priority over pledges and mortgages);
- (b) tax obligations of the company, which include all principal tax and administrative sanctions (in the form of interest, fines, increase and cost of tax collection);
- (c) secured creditors (with security right such as pledge, fiducia security and Hak Tanggungan);
- (d) other unsecured creditors given priority under Article 1149 of the Civil Code, which include laborers' wages during the last year and those which are due for the current year, including the amount of any raise of that wage;
- (e) ordinary unsecured creditors; and
- (f) equity holders.

Under Indonesian Company Law, debt holders are given priority over equity holders.

8. Is interest on debt incurred to acquire a company in Indonesia deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Interest

Interest is generally deductible for tax purpose. However, interest on debt to acquire a company's shares is not deductible if the dividend from the shares is not considered as a taxable income.

Thin capitalization

The tax law authorizes the Minister of Finance to determine the debtto-equity ratio of an Indonesian company for the purpose of determining its tax liability. Under Minister of Finance Regulation No. 169/PMK.010/2015, the debt-to-equity ratio for tax calculation purpose is set at 4 to 1. This regulation only applies to certain resident corporate taxpayers whose capital consists of shares. The corporate taxpayers that are not subject to this regulation are corporate taxpayers engaging in the banking sector, financial institution sector, insurance and re-insurance sector, certain mining and oil and gas sectors, business activities where the income is subject to final income tax, and the infrastructure sector.

If the corporate taxpayers that are subject to this regulation cannot meet the requirement of the 4 to 1 debt-to-equity ratio, their deductible borrowing costs will be limited to an amount that is in line with the 4 to 1 debt-to-equity ratio.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Indonesia?

Under the Bankruptcy Law, the curator has the right to revisit all of the contractual arrangements made by the debtor. Basically, the curator will honor the arrangement made by the debtor unless that arrangement is considered to be not in the best interests of the bankruptcy estate.

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Italy

 Is there any prohibition on a company incorporated in Italy providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Joint stock companies

The Italian Civil Code (**Civil Code**) used to prohibit any company incorporated in Italy in the form of a joint stock corporation (*società per azioni*) (**S.p.A.**) from granting loans and/or guarantees/security interests for the purpose of supporting the purchase of, or the subscription for, its own shares (**Financial Assistance**).

From 30 September 2008, the granting of Financial Assistance by an Italian company incorporated in the form of an S.p.A. is no longer prohibited if the following "whitewash" procedure set out in Article 2358 of the Civil Code is complied with:

- (a) the granting of Financial Assistance has been authorized by an extraordinary shareholders' meeting of the company providing the Financial Assistance;
- (b) the directors of the company providing the Financial Assistance (Relevant Company) have prepared a written report outlining the details of the proposed transaction, from a legal and economic perspective (Transaction Report), explaining, inter alia, the reasons behind the proposed transaction, the risks for the liquidity and the solvency of the Relevant Company, indicating the purchase price that will be paid by the relevant purchaser and certifying that the proposed transaction will take place at arm's length;

- (c) if the Financial Assistance is aimed at permitting the Relevant Company to acquire owned shares, then:
 - (i) the extraordinary shareholders' meeting referred to in (a) above must also authorize the terms for the disposal of those shares; and
 - (ii) the purchase price of the shares must be calculated on the basis of certain criteria (which vary depending on whether or not the shares are listed on a regulated market);
- (d) if the Relevant Company is required to provide Financial Assistance for the purpose of enabling its directors, the directors of its parent company or the parent company itself to purchase its shares, the Transaction Report must also attest that the proposed transaction "pursues" the best interest of the Relevant Company itself; and
- (e) the aggregate amount of the loans and the guarantees/security interests granted by the Relevant Company cannot exceed the aggregate amount of its profits and reserves available for distribution as shown in the most recently approved balance sheet of the Relevant Company (net of any amount applied by the same company for the acquisition of its own shares in accordance with Article 2357 of the Civil Code). In this respect, the Relevant Company must record in its balance sheet a reserve, not available for distribution, equal to the amount of the aggregate Financial Assistance granted.

Neither a shareholders' authorization nor any other requirements (except for the need to record details in a balance sheet as described above) will apply to transactions aimed at allowing the employees of a company, or of any other company controlling, or controlled by, that company to acquire its own shares.



Limited liability companies

Article 2474 of the Civil Code applies to companies incorporated in the form of limited liability companies (*società a responsabilità limitata*). The "whitewash" procedure does not apply to these companies. A limited liability company is prohibited from providing Financial Assistance in any manner.

2. What are the implications under the corporate benefit laws of Italy for a company providing financial assistance?

If a company breaches the Financial Assistance prohibition, any loan, guarantee or security provided as financial assistance is void, null and unenforceable. Also, the breach may result in personal liability of the directors of the company granting or issuing the loans, guarantees or security interests for breach of their duties arising out of law (article 2392 of the Civil Code).

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Security over shares (*società per azioni*) nd over quotas (*società a responsabilità limitata*) is taken in the form of a pledge. The relevant perfection formalities are:

- (a) in relation to a pledge over shares:
 - (i) a notarized endorsement in favor of the secured party of the certificates representing the shares; and
 - (ii) the annotation of the creation of the pledge in the shareholders' ledger held by the company; and

- (b) in relation to a pledge over quotas:
 - (i) the registration of the creation of the pledge with the competent Chamber of Commerce; and
 - (ii) the annotation of the creation of the pledge in the quotaholders' ledger of the company, to the extent kept by the company.

No governmental approval is needed.

To the extent that the "Imposta Sostitutiva" regime does not apply to the loan secured by the share pledge (generally 0.25% on the amount of the disbursed loan), the creation of security rights in Italy is subject to the payment of a registration tax to the competent Tax Registry Office (**Registration Tax**).

The amount of the Registration Tax varies depending on whether the security secures obligations of:

- (a) the security provider only; and/or
- (b) a third party.

The Registration Tax is levied at a flat rate of EUR 200, if the security secures obligations of a security provider only, and at 0.5% of the lower of the secured amount and the value of the collateral, if the security secures obligations of a third party.

Other security can be given in the form of:

- (a) mortgages, for real estate properties;
- (b) pledges and security assignments, for receivables;
- (c) special privilege, for plants, raw materials, goods acquired by using the proceeds of the loan granted to the company and secured



by the special privilege and receivables deriving from the sale of the relevant assets; and

- (d) personal guarantees.
- 4. How long, following acquisition of a foreign target company, would it usually take in Italy for an Italian subsidiary of the foreign target company to grant a guarantee/security?

No special rules apply.

5. Are there any restrictions on foreign banks lending to companies in Italy? Are interest payments to foreign banks typically subject to withholding tax?

A non-EU bank must be authorized by the Bank of Italy to carry out lending activities in Italy.

Pursuant to the EU Regulation no. 468/2014 (EU Regulation) of the European Central Bank (ECB), a significant supervised bank (SSB) willing to perform lending activity in Italy through the establishment of an Italian branch shall notify its intention to the national competent authority where the SSB has its head office, in accordance with the provisions set out in the 2013/36/EU Directive. The relevant national competent authority shall immediately inform the ECB of receipt of such notification. Where no decision to the contrary is taken by the ECB within two months of receipt of such notification, the branch may be established and commence its activities. The ECB shall then inform the Bank of Italy accordingly.

On the contrary, a less significant supervised bank (Non-SSB) wishing to establish a branch in Italy shall notify its intention to the national competent authority where the Non-SSB has its head office. Where no decision to the contrary is taken by such national competent authority within two months of receipt of such notification, the branch may establish and commence its activities. In this case, the national

competent authority shall inform the ECB and the Bank of Italy accordingly.

Pursuant to the EU Regulation, a SSB willing to perform lending activity in Italy for the first time on a cross-border basis shall notify its intention to the national competent authority where the SSB has its head office, in accordance with the provisions set out in the 2013/36/EU Directive. The relevant national competent authority shall immediately inform the European Central Bank and the Bank of Italy of receipt of such notification.

On the contrary, a Non-SSB willing to perform mutual recognition banking activities in Italy for the first time shall notify its intention to the national competent authority where the Non-SSB has its head office. The notification is also made to the European Central Bank and to the Bank of Italy.

Although there are some specific exceptions, withholding tax generally applies to interest payments made to foreign banks.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Italy, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

A first demand guarantee guaranteeing the fulfillment of the payment obligations must be granted by the purchaser. Alternatively, the purchaser may make a deposit on a blocked bank account and provide the relevant depositary bank with irrevocable instructions to utilize the amounts standing to the credit of that bank account only for the purposes of fulfilling the payment obligations of the purchaser.

The *Commissione Nazionale per le Società e la Borsa*, the Italian public authority responsible for regulating the Italian securities market, is entitled to assess the worthiness of the first demand guarantee granted by the purchaser and require its replacement or an increase of the amount of the guarantee.



7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Creditors rank *pari passu* unless given priority by privileges established by law, pledges and mortgages.

The holders of the following claims rank in the following descending order of priority:

- (a) pre-deductible credits (*crediti prededucibili*) (i.e., credits arisen in connection with the relevant insolvency proceeding);
- (b) secured creditors' claims; and
- (c) unsecured creditors' claims.

Other (special) privileges may be established by special laws.

Debt holders are given priority over equity holders by law.

8. Is interest on debt incurred to acquire a company in Italy deductible from earning for tax purposes? Are there any thin capitalization thresholds?

As a general rule, financing expenses will be tax deductible in the hands of an Italian acquirer, irrespective of whether the transaction is structured as an asset deal or as a share deal.

However, restrictions on interest deduction apply in relation to the excess of interest expenses over interest income (**Net Interest**). The Net Interest is then deductible within a threshold represented by 30% of the company's EBITDA (**Gross Profit**). The Net Interest exceeding the 30% threshold may be carried forward and deducted in the following tax periods without a time limit to the extent that the Net Interest accrued in those tax periods is less than 30% of the Gross Profit. For tax periods beginning on or after 1 January 2010, any part

of the unused 30% threshold may be used to increase the relevant threshold of the following tax periods.

If a company is part of a domestic tax consolidation regime, any excess of Net Interest over 30% of the Gross Profit, and any Net Interest carried forward generated after inclusion in the tax consolidation, may be used to offset the taxable income of the fiscal unit up to the limit (30%) of another company's Gross Profit to the extent that the latter has not been entirely used to deduct its own Net Interest in the same tax periods.

The computation of Gross Profit is made in accordance with the rules relating to statutory financial statements (instead of tax rules). More precisely, Gross Profit is calculated as the difference between Gross Revenues and Production Costs, per letters A and B, respectively, of the Profit and Loss Accounts model set out in Article 2425 of the Civil Code, before depreciation and amortization of intangible and tangible assets (per letters 10(B)(a) and 10(B)(b) of Article 2425 of the Civil Code) and expenses related to the financial leasing of tangible assets (per letter 8(B) of same Article 2425). The statutory financial statements are prepared in accordance with Italian accounting principles. Corporations applying IAS/IFRS to their annual statutory accounts must consider the corresponding items of the profit and loss accounts for the calculation of the gross profit.

Starting from the fiscal year following that running as of 7 October 2015, distributed dividends, deriving from participation in non-resident companies in which the Italian company holds the majority of the voting rights in the ordinary shareholders' meeting, are taken into consideration for the purposes of the calculation of the Gross Profit.

For the purposes of applying restrictions on interest deduction, the definition of interest includes interest income or expenses relating to loans, financial leasing, bonds and similar securities, as well as any other interests or expenses originating from relationships of a financial nature that essentially led to the borrowing of funds.



9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Italy?

In principle, liquidators/receivers are free to disregard the subordination provisions contractually agreed on by the parties.

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Japan

1. Is there any prohibition on a company incorporated in Japan providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Under Japanese law, there is no direct prohibition against a company providing financial assistance in connection with the acquisition of shares in itself or its parent company.

A company may theoretically provide financial assistance (i.e., loans, guarantees or security) in connection with the acquisition of its shares or its parent company's shares. In practice, however, a target company will not provide any financial assistance to the acquirer, unless and until it is wholly owned by one or more shareholders, each of whom is a party to the acquisition (see the answer to question 2 below).

If a subsidiary of the target company is wholly owned by its parent company at the time of the share purchase, that subsidiary may provide financial assistance concurrently with the acquisition. If the target company is owned by more than one shareholder and most shareholders are party to the share purchase transaction(s), including in the case of a takeover bid (**TOB**), neither the target company nor its subsidiaries will provide financial assistance until the completion of squeeze-out procedures.

2. What are the implications under the corporate benefit laws of Japan for a company providing financial assistance?

The concept of corporate benefit relates to the "duty of care" provided under Article 330 of the Companies Act (Act No. 86 of 2005, as amended) (**Companies Act**) and Article 644 of the Civil Code (Act No. 89 of 1896, as amended) (**Civil Code**) or the "duty of loyalty" of the directors provided under Article 355 of the Companies Act, which stipulates that directors are required to act for the benefit of the



corporation. Since the ultimate beneficiaries of the corporation are its shareholders, it is generally understood that any actions that do not harm the interests of the shareholders will not violate the duty of care and duty of loyalty. There is an argument that the directors' duty of care/loyalty should also be owed to the creditors of the company, but this argument has not gained much traction.

Accordingly, a target company will not, in practice, provide financial assistance where only some of its shareholders are selling their shares. If a target company were to provide financial assistance for a sale of less than all of its shares, the transaction could prejudice those shareholders who do not sell their shares, and by doing so, constitute a violation of the directors' duty of care/loyalty. Therefore, financial assistance is only provided after all of the target company's shares have been acquired.

Conversely, if each of the target company's shareholders is party to the share purchase transaction, then the target company may provide financial assistance concurrently with the acquisition.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The security package in connection with acquisition finance transactions in Japan generally includes all assets of the target company and all shares issued by the target company and the acquirer.

However, as Japanese law does not have the concept of a floating charge, a security interest needs to be established separately for each asset. The basic security package for an acquisition finance transaction commonly includes the types of security referred to below.

Share Pledges over the target company, its subsidiaries and the acquirer (typically an acquisition SPV)

Under the Companies Act, an unlisted company may, in its articles of incorporation, choose whether to issue physical share certificates.

If share certificates are issued, the pledge is established by:

- (a) an agreement between the parties; and
- (b) physical delivery of the share certificates to the pledgee (Article 146-2 of the Companies Act).

The share pledge is perfected by the pledgee's continuous possession of the share certificates (Article 147-2 of the Companies Act).

If the company does not issue share certificates, the pledge is established by:

- (a) an agreement between the parties; and
- (b) registration on the shareholders' register maintained by the issuing company (a trust bank is often appointed as a shareholders' register agent to maintain the register on behalf of the issuing company).

Lenders generally require the issue of share certificates when establishing a pledge over the shares to ensure their control of any subsequent transactions in the shares, which may require amendment of the target company's articles of incorporation.

Dematerialized shares

Transactions involving the shares of a listed company are conducted through a book-entry system maintained by the Japan Securities Depository Center Inc. (**JASDEC**). Under this book-entry system, system participants such as security firms and banks (each a



Custodian) deposit their customers' stocks or other securities in JASDEC on the basis of a custody arrangement.

The delivery of dematerialized securities in connection with a transfer, pledge or security assignment is processed by book-entry transfers between customer accounts maintained by the Custodian and/or the participant accounts maintained at JASDEC (i.e., no physical delivery is made). The shares of the target company will be transferred to the purchaser's account at the Custodian through this book-entry system.

The Law Concerning Clearance of Bonds and Stocks, etc. provides that a pledge over shares can be created by an agreement between the parties, and the transfer of the shares to the pledge sub-account of the pledgee at the Custodian. As Japanese law does not recognize the concept of a security agent, however, the relevant account must be in the name of each secured party for the pledge to operate in its favor unless a security trustee structure is established. If a security trustee structure is established, the account would be solely in the name of the security trustee (which is a licensed entity).

The dematerialization of listed shares is mandatory and physical share certificates are no longer issued.

Bank account pledges

Lenders in Japan often demand that the borrower and the target company open bank accounts with a member of the loan syndicate and that the business uses those accounts exclusively. The reasons for this include the following:

- (a) the lenders prefer to have control over the target's accounts and use them to monitor the target's cash flow;
- (b) the lenders may be able to set off any obligations owing to the borrower; and

(c) it may be difficult to establish security over bank accounts held at other banks and funds in those accounts could be subject to set-off by the account bank.

In order to establish a pledge over a bank account, both:

- (a) an agreement between the parties; and
- (b) the date-certified written consent of the account bank (date certification is done by a notary public and is required for perfection),

are required.

Security assignment of present and future receivables of the target company and its subsidiaries

While the security assignment concept does not appear in the Civil Code, its use has been accepted by the Japanese courts and it is an important tool for creating security in Japan. A security assignment is created by transferring the underlying assets (in this case, receivables) under a security assignment agreement.

Future receivables may be assigned to the extent the receivables subject to assignment are appropriately specified.

There are three options for perfecting a security assignment over receivables:

- (a) date-certified notice to the underlying obligor (generally delivered by certified mail);
- (b) obtaining the date-certified consent of the underlying obligor; or
- (c) registration of the assignment at the Legal Affairs Bureau.

One or more of the options may be used depending on the circumstances. If the target is providing a security interest over an



inter-company loan, for example, date-certified consent is ordinarily obtained. Conversely, registration is generally used where there are a large number of underlying obligors. Please note, however, that registration of an assignment only perfects the assignment against third parties. Registration does not perfect the assignment against the underlying obligors, and notice to the underlying obligors will therefore still be required for enforcement purposes.

Security assignment of movable assets

A security assignment of movable assets is established by an agreement between the parties and perfected either by delivery of the movable assets to the secured party or registration of the security assignment at the Legal Affairs Bureau. Physical delivery of the assets is not required if the parties agree that the security provider has "delivered" the underlying assets but retains them on behalf of the secured parties. This form of delivery is referred to as "constructive delivery."

Prospective purchasers are not required to enquire as to whether a security interest has been registered in respect of an asset they wish to purchase. Therefore, the effect of the registration is no different from delivery of the assets and will not protect the secured parties from a bona fide purchaser acquiring the assets.

In order to avoid a possible sale of the assets to a bona fide purchaser, the lenders will sometimes demand that the security provider put labels/plaques on the assets to show that they are subject to security.

Mortgage over real estate of the target company and its subsidiaries

A mortgage is established by an agreement between the parties and, to be perfected, must be registered at each local Legal Affairs Bureau in which the relevant property is located. The application for registration is made by both parties to the mortgage, generally through a qualified judicial scrivener acting on behalf of both parties. A registration tax of 0.4% of the secured obligation (i.e., principal amount of the loan) is

assessed on the initial registration, and a nominal charge will apply to any subsequent registrations securing the same obligations.

Due to the registration tax, a mortgage is sometimes only registered on a provisional basis until the time that a specified event (such as a default) occurs. Provisional registration of a mortgage involves only nominal costs and preserves the priority of the mortgagee from the time provisional registration is applied for, but the provisional registration must be converted to a full registration (and the registration tax paid) prior to any enforcement of the mortgage. Full registration is therefore preferable to lenders, but the choice between provisional and full registration often depends on the relative bargaining position of the parties.

Real estate and any movable assets ancillary to them in connection with a factory or other facility specified under the various "Foundation Mortgage" laws may be registered as a single package of assets for the purpose of creating a mortgage over those assets.

4. How long, following acquisition of a foreign target company, would it usually take in Japan for a Japanese subsidiary of that foreign target company to grant a guarantee/ security?

There is no statutory waiting period following the acquisition of a foreign parent company in relation to the provision of security by its wholly owned Japanese subsidiaries. Therefore, a wholly owned Japanese subsidiary of a foreign parent may provide a guarantee/security immediately on completion of the acquisition and the borrower obtaining control of the Japanese subsidiary. Registration of security interests with the Legal Affairs Bureau generally takes approximately one or two weeks to complete but the perfection of the security interests is deemed to occur at the time of the application for registration rather than on the completion of registration.



5. Are there any restrictions on foreign banks lending to companies in Japan? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

A money lending business license (or banking license) is required if a person (including legal entities) is to be engaged in the business of providing loans in Japan. Generally, foreign banks, which conduct business in Japan, have obtained a Foreign Bank Branch License under the Banking Act (Act No. 59 of 1981, as amended) and may provide loans to companies in Japan under that license.

If the foreign bank is providing only a single loan in Japan, an argument can be made that the lending will not fall within the definition of a "business" and that the bank should therefore not be required to obtain the relevant license. However, to the extent the loan is made by a foreign bank (which generally would provide loans as part of its business), that argument is unlikely to succeed and the relevant license under the Money Lending Business Act (Act No. 32 of 1983, as amended) or Banking Act will be required.

Withholding tax

A withholding tax of 20.42%, subject to any tax treaties, will be applied to any interest payments made to banks in foreign jurisdictions.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Japan, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

A person who intends to acquire shares via a TOB must submit a TOB application to the Local Finance Bureau (Article 27-3.2 of the Financial Instruments and Exchange Act (Act No. 25 of 1948, as amended)). At the time the TOB application is submitted, the acquirer

must also submit evidence that it has sufficient funds available to purchase any shares offered in response to the TOB.

Where the acquirer uses financing from banks, the banks must submit a Certificate of Funds based on the commitment letter issued by the banks. The Certificate of Funds must include a summary of the conditions precedent to funding. By extension, the conditions precedent to funding must therefore be agreed prior to filing the TOB application. The commitment letter generally contains the basic terms and conditions of the loan. It is not necessary for the loan agreement to be executed on, or prior to, the submission of the TOB application.

In practice, the loan agreement continues to be negotiated even after submission of the TOB application and is executed a couple of days prior to the end of the TOB offer period of between 20 and 60 business days, as determined by the acquirer and set out in the TOB application.

If the bank does not provide the loan to the acquirer despite the success of the TOB, the bank may be liable for breach of the commitment letter. The liability for that breach depends on the extent to which the banks have committed to providing the loan and the terms and conditions of the loan. Although most commitment letters contain a disclaimer of liability by the banks, the banks will, in practice, almost certainly provide the loan once they have submitted the Certificate of Funds due to the potential impact on shareholders and the reputational risk to the banks.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

The priority between debt holders and equity holders is stipulated in Article 502 of the Companies Act. Under Article 502, a company cannot distribute the residual value of its assets unless the company has paid its debts in full. Accordingly, debt holders will be paid prior



to equity holders in the event of an insolvent liquidation of the company.

Secured creditors may exercise their security interests outside insolvency procedures. Secured creditors will, in this manner, generally enjoy priority over unsecured creditors (see the answer to question 9).

8. Is interest on debt incurred to acquire a company in Japan deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Interest payments on debt used to fund an acquisition are tax-deductible in Japan.

There are thin capitalization rules limiting interest payment deductions for companies in Japan that are leveraged in excess of certain thresholds. The rules apply only to foreign-owned Japanese companies that raise funds from foreign controlling shareholders or third parties related to foreign controlling shareholders.

Under the rules, interest payments are excluded from a company's deductible expenses to the extent those interest payments relate to debt owed to its foreign controlling shareholders and/or third parties related to its foreign controlling shareholders and to the extent the debt exceeds three times the company's net equity. Alternatively, a company has the option of using a reasonable debt-to-equity ratio for a comparable Japanese company that operates a similar business and has similar characteristics (i.e., size of business, etc.).

Under the thin capitalization rules, the deduction of interest payments will be denied to the extent those interest payments relate to a taxpayer's debt that exceeds the maximum allowable level.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Japan?

The nature of the contractual subordination determines whether it will be honored by a bankruptcy administrator. There are three forms of contractual subordination that may be applicable.

Contractual Subordination under the Bankruptcy Act

Article 99.2 of the Bankruptcy Act (Act No. 75 of 2004, as amended) provides for contractual subordination under an agreement between a creditor and a borrower by which the claims of that creditor are subordinated to the claims of the general unsecured creditors of the borrower in the event of bankruptcy. This type of contractual subordination will be honored by a bankruptcy administrator, but is not often seen in acquisition finance transactions, particularly where security is taken by the lenders.

The effect of this type of contractual subordination is that the priority of the subordinated creditor's claims will fall between the general unsecured creditors' claims and the equity holders' claims.

Contingent Claims

Under this type of contractual subordination, the loan agreement will stipulate that the claims of the mezzanine/junior lender will, if a certain trigger event occurs (e.g., an event of default or acceleration), become contingent on the payment in full of the claims of the senior lender. This means that the claims of the mezzanine lender essentially cease to exist until the claims of the senior lender are satisfied.

A bankruptcy administrator will, in effect, honor this type of contractual subordination as the claims of the mezzanine lender will not exist at the time of the insolvency. This arrangement is quite common in Japan and effectively secures the priority of the senior lender but it is not popular among mezzanine lenders as it may yield perverse results for the mezzanine lender.



To illustrate, consider a situation where the borrower has assets other than the assets provided as security. There are three possible general scenarios in relation to the mezzanine lender's position. To the extent that the value of the assets provided as security equals or exceeds the senior claims, the mezzanine lender's priority will not be adversely affected.

Value of assets provided as security equals or exceeds senior claims

If the value of the secured assets exceeds the senior claims, the senior claims will be paid in full and the mezzanine claims will resurface. The mezzanine claims may be secured by the remaining value of the secured assets.

Value of assets provided as security equals senior claims

If the value of the secured assets equals the senior claims, then the senior claims will be paid in full, the mezzanine claims will resurface and the mezzanine lender will be in the same position as that of the general unsecured creditors since the secured assets will have been applied to discharge the senior claims.

Value of assets provided as security less than senior claims

If, however, the secured assets are insufficient to satisfy the senior claims, the mezzanine lender's claims will only resurface if the senior claims are paid in full through the pro rata payment to the senior lender from the pool of assets not provided as security. Therefore, the mezzanine lender will effectively be subordinated to both the senior lender and the general unsecured creditors until the senior claims are paid in full. To mitigate this effect, the mezzanine lender may have a right to repay the remaining amount of the senior claims on behalf of the borrower

Subordinated Claims

Where the claims of the mezzanine lender remain but are contractually subordinated to the senior lender under an inter-creditor agreement, a bankruptcy administrator will set aside the contractual subordination and, in the case of secured creditors, distribute the proceeds from the secured assets in accordance with the order of registration or, if registered simultaneously, pro rata between the secured lenders.

While a senior lender may rely on the claw-back provisions of the inter-creditor agreement, where the bankruptcy administrator has made payments to a mezzanine lender prior to the satisfaction of the senior claims, the senior lender will then be taking on both the performance risk and credit risk of the mezzanine lender.

Whether contingent claims or subordinated claims are used generally depends on the relative bargaining power/position of the senior and mezzanine lenders.

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Luxembourg

 Is there any prohibition on a company incorporated in Luxembourg providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Permitted on certain conditions

The prohibition on a Luxembourg company providing financial assistance was repealed in 2009.

Article 49-6 et seq. of the law of 10 August 1915 (as amended) relating to commercial companies (**Companies Law**) regulates the provision of financial assistance by a Luxembourg company. Financial assistance in the Grand Duchy of Luxembourg is permitted but restricted since the repeal of the law on 10 June 2009.

The rule is that a company may directly or indirectly advance funds or make loans or provide security with a view to the acquisition of its shares by a third party subject to the restrictions set out below.

The legal framework expressly applies to public limited liability company (*sociétés anonyme*), European companies (*sociétés européennes*) according to Article 49-6 of the Companies Law and partnerships limited by shares (*sociétés en commandites par actions*) according to Article 103 of the Companies Law.

The Companies Law does not have any particular rule for private limited liability companies (*société à responsabilité limitée*).

Financial assistance may not take place unless:

(a) the board of directors or the management board takes responsibility for ensuring that these transactions take place under fair market conditions, especially in relation to interest received by the company and security provided to the company for the loans and advances referred to above. The credit standing of the

- third party or, in the case of multiparty transactions, of each counterparty, involved in the transaction must have been duly investigated;
- (b) the transactions must be submitted by the board of directors or the management board for prior approval to the general meeting of shareholders deliberating under the same conditions as for amendments to the articles of association (i.e., with a quorum of at least half of the share capital present or represented and a majority of two-thirds of votes). The board of directors or the management board must present a written report to the general meeting of shareholders, stating the reasons for the transaction, the interest of the company in entering into the transaction, the conditions of the transaction, the risks involved for the liquidity and solvency of the company and the price at which the third party is to acquire the shares. The report must be lodged at the Luxembourg Register of Commerce and Companies and be published in the *Mémorial C* (Luxembourg official gazette for companies) (respectively, as of 1 June 2016, in the Recueil Electronique des Sociétés et Associations (RESA), which will replace the Mémorial C);
- (c) the aggregate financial assistance granted to third parties must at no time result in the reduction of the net assets of the company below an amount equivalent to the share capital, plus undistributable reserves. Furthermore, an undistributable reserve equivalent to the amount of the aggregate financial assistance must be booked in the liabilities of the company; and
- (d) where a third party, through the financial assistance of a company, acquires that company's own shares or subscribes for shares issued in the course of an increase of the share capital, that acquisition or subscription must be made at a fair price.

Special report

If:

(a) members of the board of directors of a company;



- (b) the management board of a company;
- (c) members of the board of directors of a parent company;
- (d) members of the management board of a parent company;
- (e) the parent company itself; or
- (f) third parties acting in their own name but on behalf of:
 - (i) the company,
 - (ii) the members of the board of directors; or
 - (iii) the management board,

are party to a transaction where there is financial assistance then the supervisory auditor (Commissaire aux comptes) or the statutory auditor (réviseur d'entreprise agréé) must provide a special report on the transaction to the general meeting of shareholders who will vote on that report.

Definitions

A third party is any legal or natural person, i.e. any true third party or a parent company (either direct or indirect), individual shareholders, creditors or employees.

The acceptance of the company's own shares as security either by the company itself or by a person acting in his/her own name, but on behalf of the company, is treated as an acquisition falling under the financial assistance limitation

Exemptions for banks, employees and investment companies

The above restrictions apply neither to transactions concluded by banks and other financial institutions in the normal course of business. nor to transactions effected with a view to the acquisition of shares by or for the employees and staff of the company. However, the relevant

transaction must at no time result in the reduction of the net assets below an amount equivalent to:

- (a) the share capital; plus
- (b) undistributable reserves.

The financial assistance limitation will also not apply to the acquisition of fully paid-up shares issued by an investment company with fixed capital and acquired at the investor's request by that company or by a person acting in his/her own name by on behalf of that company.

Criminal offense

A person or entity that breaches the rules set out above is subject to criminal law. Under Article 168 of the Companies Law, any person acting in his/her capacity as director of a company who made loans or advances using company funds on shares or other interests in the company contrary to the rules of Articles 49-6 and 49-7 of the Companies Law relating to financial assistance will be subject to a jail term of one month to two years and/or a fine between EUR 5,000 to EUR 125,000.

Providing security, however, is not a criminal offense even if made in breach of the Companies Law.

2. What are the implications under the corporate benefit laws of Luxembourg for a company providing financial assistance?

Directors of a Luxembourg company are liable to the company under general law for the performance of the mandate given to them and for any misconduct in the management of the company's affairs. They are also jointly and severally liable both to the company and any third parties for damages resulting from any breach of the Companies Law or the articles of association of the company.



Whenever a director has a conflict of interest in relation to a transaction in which the company is involved and in relation to which the board of directors will vote, that director must notify the board of the conflict. The relevant director must make a record of the notified conflict in the minutes of the meeting and the director must not take part in the relevant deliberations nor vote.

Directors may also face civil liability for mismanagement in addition to the criminal penalties stated in the answer to question 1.

Furthermore, any legally appointed or *de facto* director who in bad faith:

- (a) makes use of the assets or the credit of the company which he/she knew was contrary to the company's interests, either for personal purposes or for the benefit of another company or undertaking in which he/she was directly or indirectly interested in; and
- (b) makes use of the power he/she has or of the vote he/she could cast, in his/her capacity as director, which was contrary to the interests of the company either for personal purposes or for the benefit of another company or undertaking in which he/she was directly or indirectly interested in,

faces a potential jail term of one to five years and/or a fine in the amount of EUR 500 to EUR 25,000.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Typical security

The most typical securities taken in acquisition finance transactions in Luxembourg are:

- (a) a security interest (such as a pledge) and/or title transfer security interest over shares, debt instruments, claims or balance of bank accounts;
- (b) suretyship (cautionnement); and
- (c) for any land, mortgage (hypothèque).

Pledge

Perfection of pledge agreements may require registration in the share register, notification to banks or to debtors, made under private seal. For public limited liability companies (*société anonyme*) when shares are registered, perfection is made through registration in the register. If private limited liability companies (*société à responsabilité limitée*) are involved, perfection of a pledge is made through the notification to, or the acceptance by, the company that issued the shares. Perfection requirements need to be checked on a case-by-case basis.

No stamp duty or registration with official authorities in Luxembourg is needed except that, for the purposes of litigation, registration at a fixed registration duty (EUR 12) or at *ad valorem* duty (0.24% of principal amount secured) may be required.

Mortgage

A mortgage may only be created by notary deed, and is subject to registration with the Luxembourg tax administration. The basis for the calculation of the notary fees is the value of the debt secured by the mortgage. The tax administration will levy a duty of 0.05% on the value of the claim for registration and duty of 1% for the transcription. Transcription is an official recording made by the Luxembourg administration in charge of mortgages into a special mortgage registry.

Guarantee

More generally, Luxembourg companies may grant security or more commonly guarantees either to secure their own obligations or the



obligations of affiliated companies or, in more limited, cases the obligations of unrelated third parties. The instrument may be governed by Luxembourg or foreign laws and be general or limited to certain assets.

Although a company can enter into a guarantee if it is not in its corporate interest to do so (and the guarantee will be valid) doing so may trigger liability for the management of the company. If the guarantee is governed by foreign laws, it may not be enforceable in Luxembourg. The management of the grantor assesses whether it is in the company's interests to grant the security/guarantee.

Corporate interest

The notion of a company group does not exist under Luxembourg corporate law. Therefore, only the specific interest of the grantor company is taken into account, but this might include factors involving the group if this has consequences in relation to the grantor company.

The concept of "corporate interest" is pragmatic in Luxembourg and in practice varies greatly depending on the nature of the business run by the relevant entity. The key factors the company must consider are the direct benefit to the grantor company, the overall interests of the grantor and whether or not the guarantee exceeds the financial means of the grantor company.

Limit on guaranteed amount

The nature of the guarantee depends greatly on the type of project and assets at hand. The legal framework in connection with the conditions for the granting of guarantees is limited in Luxembourg law, which allows flexibility.

When upstream or cross-stream guarantees are granted, the practice has developed to include mechanisms which limit the amount of the guarantee based usually on the net asset value of the grantor. The guaranteed amount is calculated as a percentage of the net asset value of the guarantor. There is no magic formula to decide the percentage based on authority or case law but the practice, driven by lender's counsel, tends to provide for the percentage to be between 80% to 95% of the net asset value of the guarantor, subject to negotiation. The valuation of the assets might be made either when the guarantee is granted and/or at enforcement, at book value or at fair market value.

4. How long, following acquisition of a foreign target company, would it usually take in Luxembourg for a Luxembourg subsidiary of that foreign target company to grant a guarantee/security?

Timing for the granting of security will mainly depend on the number of assets, the particular company involved and the prior board and shareholder (if any) resolutions required.

In normal circumstances (i.e. when no financial assistance is involved), the perfection of security takes place on the same day as the settlement of the entire acquisition and financing transaction.

5. Are there any restrictions on foreign banks lending to companies in Luxembourg? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

EU banks may perform lending activities in Luxembourg on the basis of the freedom of services under the European "passport". This policy allows a financial services operator legally established in one EU country to establish/provide its services in another EU country without further authorization requirements. Before performing lending services in Luxembourg, an EU bank must apply for the European "passport" with their home financial supervisory authority which will transmit the request to the Luxembourg Financial Sector Supervision Commission (*Commission de Surveillance du Secteur Financier*) (Supervision Commission).



No European "passport" is necessary in case of reverse solicitation. In such a case, there are no lending services performed in Luxembourg.

Non-EU Banks do not have the benefit of the European "passport". If the following conditions are cumulatively fulfilled, the non-EU Bank will have to apply for an authorization to be granted by the Luxembourg Ministry in charge of the Supervision Commission:

- (a) the non-EU bank does not have an establishment in Luxembourg;
- (b) the non-EU bank performs a lending activity in its home country; and
- (c) one or more of its agents travel occasionally and temporarily to Luxembourg to provide lending services.

If the above conditions are not met, the non-EU bank will not be considered to be performing lending services in Luxembourg. Therefore no approval will be required.

Withholding tax

No withholding tax is due on interest payments by companies in the Grand Duchy of Luxembourg (except that a Luxembourg withholding tax may apply on interest payments made by companies to Luxembourg tax resident individuals in accordance with the law of 23 December 2005, as amended). The general principle is that unless otherwise provided by law or by contractual provisions, all assets of a debtor will be allocated to the payment of its debts.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Luxembourg, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Under Article 3 (e) of the Luxembourg act on mandatory takeover bids dated 19 May 2006 (**Takeover Law**), the offeror must ensure that he/she can fulfill in full any cash consideration, if that is offered, and

must have taken all reasonable measures to secure the implementation of any other type of consideration. This requirement applies to mandatory takeover bids over shares of Luxembourg and other EU companies listed on the Regulated Market operated by the Luxembourg Stock Exchange. The same requirement may be applied by the Supervision Commission in the case of takeover bids over shares listed on the EuroMTF Market operated by the Luxembourg Stock Exchange.

Neither the Takeover Law nor guidance published by the Supervision Commission explains how the offeror will be deemed to have satisfied the requirements of Article 3 (e) of the Takeover Law. Therefore the satisfaction of this requirement should ultimately be agreed with the Supervision Commission in advance of making the offer. The Supervision Commission has discretion in this respect, and may request to see a binding bank guarantee or letter of credit for the portion of the cash consideration that the offeror does not finance itself

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Articles 2095 et seq. of the Luxembourg Civil Code provide the rank and order of priority between creditors of a company.

A shareholder of a Luxembourg company is always in his/her capacity as shareholder, junior towards all other creditors of the company. A shareholder can only be repaid out of liquidation proceeds.

A shareholder may also grant financing to a Luxembourg company. Debt financing granted by a shareholder may be made through hybrid instruments (in which case they are generally contractually subordinated to other creditors of the company) or through pure debt instruments. In these circumstances, a shareholder's rank as creditor will depend on:



- (a) the security granted by the shareholder; and
- (b) the contractual subordination provisions,

failing which, they will be treated as ordinary creditors.

A distinction is made between privileged creditors and ordinary creditors.

Privileged creditors have a priority ranking, due either to mandatory legal provisions (such as claims for salaries by employees, tax administrations), which operate over all assets of the debtor, or securities (such as a mortgage or pledge agreement) recognized as having priority by law, where certain assets are reserved to the beneficiaries of the security.

Privileged creditors will be paid in priority taking into account their rank. Creditors having the same rank are paid their claims on a pro rata basis in relation to the relevant assets. Privileged creditors benefiting from the same type of security will rank according to:

- (a) the date of registration of the security; or
- (b) the date when the security became enforceable in relation to third parties.

Ordinary creditors will be paid out of the remaining assets (if any) once all other privileged creditors' claims have been satisfied.

Beneficiaries of a pledge agreement over financial assets as foreseen by the law of 5 August 2005 on financial collateral agreements, as amended (**Financial Collateral Law**), have a right of retention, so that even privileged creditors such as employees or tax administration cannot be paid prior to that beneficiary in respect of the pledged asset(s). Financial collateral agreements subject to the Financial Collateral Law will be enforceable against a receiver in insolvency (*curateur de la faillite*) or liquidator (*liquidateur*) even if created on the day when the insolvency or liquidation proceedings were

commenced and in certain limited circumstances, even after the commencement of those proceedings.

8. Is interest on debt incurred to acquire a company in Luxembourg deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Interest payments on debt incurred to acquire a company in Luxembourg are in principle tax deductible. However, expenses (such as interest expenses) in direct economic connection with an exempt income (e.g., dividend) are non tax-deductible.

Also, a special rule applies in Luxembourg in relation to the deductibility of expenses in direct economic connection to participations that would qualify under the Luxembourg participation exemption regime (**PEX**) for the tax exemption on capital gains. Those expenses are tax-deductible only to the extent they exceed the amount of tax-exempt capital gains realized on the sale of the participation ("recapture" rule), i.e., any potential capital gains realized on disposal of the shareholding qualifying for the PEX should in fact be tax-exempt only for the part exceeding the amount of expenses (such as interest expenses) deducted in the previous and in the current tax year.

There are no explicit thin capitalization rules under Luxembourg tax law. However, holding companies are required by the Luxembourg administrative practice to comply with a debt-to-equity ratio of 85:15 (in- and on-lending arrangements are excluded from debt-to-equity rules). Under certain circumstances, the Luxembourg administrative practice may accept a ratio of 99:1.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Luxembourg?

Subordination

Except in specific legislation like the securitization law or the Luxembourg fund regulation, Luxembourg civil law does not contain



specific provisions in relation to subordination provisions. The general admitted principle is that subordination provisions are valid between parties to an agreement but must not prejudice third parties.

Subordination may be set up in two ways as follows:

- (a) by a clause between the parties to an agreement by which rights to repayment of a particular party are subject to the full repayment of senior creditor(s); or
- (b) by a commitment from the creditors not to act before full repayments of senior creditors.

The validity of a contractual subordination clause was admitted by the Courts of the Grand Duchy of Luxembourg in the context of insolvency proceedings. In relation to the question whether a receiver in insolvency or a liquidator would respect subordination provisions deriving from a commitment of the company not to exercise rights prior to senior creditors being repaid, the general principle accepted by the Luxembourg Courts is that the receiver in insolvency or liquidator must respect all agreements entered into by the company as these proceedings do not trigger an automatic general termination of agreements. It is therefore likely that counterparties in a transaction could oppose that commitment in the case of insolvency proceedings.

Set-off

General set-off provisions exist under Article 1289 of the Luxembourg Civil Code. Where two persons are both a creditor and a debtor in relation to each other, their debts (if they are due and payable) will be extinguished automatically as a matter of law, up to the equivalent amount. When no contractual provisions prevent this automatic set-off, there is a risk that set-off takes place automatically and therefore jeopardizes the subordination clauses.

Set-off will occur even in the case of insolvency proceedings if the debts were both due and payable before the opening of the proceedings. Otherwise, no payment or set-off may take place after

the opening of insolvency proceedings unless both debts are related to the same agreement.

The Financial Collateral Law provides that the debtor of a claim provided as financial collateral may waive, in writing or in a legally equivalent manner, his/her rights of set-off as well as any other exceptions *vis-à-vis* the creditor of the claim provided as collateral and *vis-à-vis* persons to whom the creditor assigned, pledged or otherwise mobilized the claim and the waiver will be valid between parties and enforceable against third parties, even in the case of insolvency proceedings.

Furthermore, the parties in a financial collateral arrangement may agree that the financial collateral provider waives all claims it may have against the debtor of the relevant financial obligations in case of an enforcement event. That waiver will be valid between parties and enforceable against third parties.

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Malaysia

 Is there any prohibition on a company incorporated in Malaysia providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

General prohibition

Section 67 of the Malaysian Companies Act 1967 (**CA**) prohibits the provision of financial assistance by a company for the acquisition of shares in that company or its parent company, subject to limited exceptions. Section 67(1) provides that no company shall give, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company, or in any way purchase, deal in or lend money on its own shares

Nevertheless, there is judicial authority to support the principle that a bona fide transaction entered into in good faith will not be caught by Section 67(1). To determine whether a transaction is bona fide, the following matters, among other things, will be taken into account:

- (a) whether the transaction was entered into with the sole or substantial purpose of providing financial assistance to allow the acquisition of or subscription for shares in the company or its holding company;
- (b) whether the transaction was genuinely entered into for the company's benefit; and
- (c) whether the transaction results in a dissipation of the company's financial resources.

Exceptions

Section 67(2) provides for limited exceptions to the general prohibition above. Under Section 67(2), nothing in subsection (1) shall prohibit:

- (a) where the lending of money is part of the ordinary business of the company, the lending of money by the company in the ordinary course of its business;
- (b) the provision by the company, in accordance with any scheme for the time being in force, of money for the purchase of or subscription for fully paid shares in the company or its holding company, being a purchase or subscription by trustees of or for shares to be held by or for the benefit of employees of the company, or a subsidiary of the company, including any director holding a salaried employment or office in the company or a subsidiary of the company; or
- (c) the giving of financial assistance by the company to persons, other than directors, bona fide in the employment of the company or a subsidiary of the company, with a view to enabling those persons to purchase fully paid shares in the company or its holding company to be held by themselves by way of beneficial ownership.

Further exceptions include:

- (a) a court-ordered compulsory purchase of shares by the company in the event of oppression in disregard of members' interests or unfair discrimination or prejudicial conduct under Section 181 of the CA;
- (b) the redemption of preference shares; and
- (c) the capitalization of a share premium account.



Consequences

A company that fails to comply with Section 67 is not guilty of an offense, though its officers, if found guilty, may be imprisoned for a period of up to five years or fined a sum of up to RM100,000, or both. Further, on conviction, a court may order the officer to make payment of compensation and the order may be enforced as if it were a judgment.

Significantly, nothing in Section 67 shall operate to prevent a company or person from recovering the amount of any loan made in contravention of the section or any amount for which it becomes liable, either on account of any financial assistance given, or under any guarantee entered into or in respect of any security provided in contravention of this section.

Publicly listed companies

Notwithstanding the above, Section 67A of the CA allows a publicly listed company with a share capital to purchase its own shares if authorized by its articles of association. In order to do so:

- (a) the public company must be solvent on the date of the purchase and must not become insolvent by incurring the debts involved in the obligation to pay for the shares so purchased;
- (b) the purchase must be made through Bursa Malaysia (the Malaysian stock exchange) on which the shares of the company are quoted and in accordance with the relevant rules of Bursa Malaysia; and
- (c) the purchase must be made in good faith and in the interests of the company.

The company must also, within 14 days after the shares are purchased, lodge with the Companies Commission of Malaysia (**CCM**) and Bursa Malaysia a notice in the prescribed form.

A company, every officer of the company and any other person in default of Section 67A is guilty of an offense and subject to imprisonment for up to five years or a fine of up to RM100,000, or both.

2. What are the implications under the corporate benefit laws of Malaysia for a company providing financial assistance?

In Malaysia, directors of a company have a fiduciary duty to act in the bona fide interests of the company as a whole and not for any collateral purpose.

What constitutes the "interests of the company as a whole" will depend on the context in which it is used. It may include the interests of:

- (a) the company as a corporate entity;
- (b) the company's shareholders;
- (c) the company's creditors (where the company is unable to pay its debts); or
- (d) the interests of the company as a group.

Where a company is part of a group of companies, the general rule is that the directors of a company are to act in the bona fide interests of that company as opposed to the interests of other companies in the group or the group as a whole. Nevertheless, the courts have held that it is permissible for directors to consider the interests of the group as a whole insofar as these are not detrimental to the company itself or where the interests of the company are inextricably bound to the interests of the other companies in the group or the group as a whole.



3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Shares

In general, security is taken over shares by way of creating a charge over those shares in favor of the lender.

If the charge is created by a Malaysian company, under Section 108 of the CA, the particulars of the charge must be lodged for registration with the CCM (by way of a statutory form known as a Form 34) within 30 days of the creation of the charge.

The lender will usually receive a certificate of registration (commonly referred to as a Form 40) within approximately one month from the date of lodgment of the Form 34. Brief details of the charge created will be revealed in the official search results issued by the CCM when a company search is conducted with the CCM in relation to the company. As provided in Section 108(1) of the CA, if the creation of the charge is not lodged with the CCM within the prescribed time frame and form, the charge will, insofar as any security on the company's property or undertaking is conferred by the charge, be void against the liquidator and any creditor of the company.

In relation to shares listed on Bursa Malaysia, the shares would be paperless and, when charged by the borrower under the appropriate documentation, should be transferred to a pledged securities account opened either in favor of the lender as pledgee or in the name of an authorized nominee. In relation to unlisted shares in a private limited company, the borrower would normally be required to execute and deposit with the lender blank undated transfer forms together with the original share certificates. Depending on the circumstances, it is also common to procure upfront undated directors' letters of resignation, letters on waiver of pre-emptive rights by other shareholders, a special

resolution authorizing amendments to constitutional documents of the company, and a confirmation letter from existing directors that they have no claims against the company if their appointment is terminated.

If the security over the shares is created to secure a foreign currency or ringgit credit facility, certain approval or registration requirements may also be imposed by Bank Negara Malaysia (**BNM**). This is discussed further in the answer to question 5 below.

On 30 June 2009, the Malaysian Prime Minister announced the liberalization of a host of restrictions on foreign investments in Malaysia. Malaysia has traditionally imposed restrictions on foreign equity participation across industries and sectors aimed at strengthening Bumiputra participation in the economy. The approval of the Foreign Investment Committee (FIC) is no longer required where shares in a Malaysian company are charged to a foreign interest.

Assets

The form of security taken over assets will depend on the nature of the assets in question. Assets commonly used as security include real property and movable property.

Real property

Security can be created over land with title or a lease over that land by way of a registered charge under Section 241(1) of the National Land Code (NLC). Under the provisions of Section 242(1) of the NLC, a statutory instrument known as Form 16A must be registered with the relevant land authorities for the charge created over the land to be effective as security. Once registered, the charge will be endorsed as an encumbrance on the title in favor of the lender and the lender will usually be entitled to custody of the original document of title.

Following the liberalization of the restrictions on foreign investments, the Malaysian Government has repealed the Guidelines on the



Acquisition of Properties by Local and Foreign Interests (**FIC Land Guidelines**). However, restrictions on the FIC Land Guidelines have been re-introduced via the Economic Planning Unit (**EPU**) effective 30 June 2009.

The approval of the EPU is required under the new Guidelines on the Acquisition of Properties (EPU Guidelines) only where it involves the dilution of Bumiputra interests (i.e., sale of property by Bumiputra to non-Bumiputra) and/or Government interests properties valued at RM20 million and above, whether bought directly or indirectly through the acquisition of companies owning properties. Except for this dilution of interests, all other property transactions (regardless of the nature of the property) no longer require the approval of the EPU.

If a Malaysian company is the registered proprietor of the land being charged, then following the execution of the land charge, the particulars of the charge must be lodged with the CCM, and the charge document and corresponding power of attorney (if any) must be stamped at a stamp office in Malaysia. If the instrument creating the charge contains a power of attorney, that power of attorney needs to be registered at the High Court in Malaya.

If the issue document of title (which is the document of title issued to the registered proprietor of land) relating to the land has not been issued, security over the land can be created by way of assignment by the borrower of all its rights, title, interests and benefits of the documentation that evidences the borrower's interest in the land, together with a duly executed power of attorney conferring full power of sale on the lender. This mode of security arrangement is common in instances where land is being sold and the issue document of title relating to that land has not been issued by the relevant authority. In those circumstances, an assignment will be created over the sale and purchase agreement.

If the documentation is not available, that is, there is no conveyance involved and no sale and purchase agreement but the issue document of title remains unissued because it is, for example, subject to alienation or sub-division exercises, a security interest can still be created over the land in the form of a specific debenture. By the specific debenture, a fixed charge will be created in favor of the chargee and the chargee will be granted the usual remedies of sale, right of possession and the right to occupy the relevant land.

Notwithstanding the above alternative security arrangements, these alternatives are merely contractual arrangements between the parties and do not create a registered indefeasible interest over the land.

The relevant documents will need to be stamped at a stamp office and a power of attorney contained in the documents (if any) will need to be registered at the High Court, as discussed above.

Movable property

Security is typically taken over movable property by way of a debenture creating fixed and floating charges over that movable property. A fixed charge will generally be created over all types of classes of assets of the company and a floating charge will generally be created over future assets and those assets that cannot be successfully charged by way of a fixed charge.

The debenture will need to be stamped at a stamp office in Malaysia and, if the debenture contains a power of attorney, it is required to be registered at the High Court.

Tax

Under the First Schedule of the Malaysian Stamp Act 1949 (SA), a loan denominated in Ringgit Malaysia will be charged at an *ad valorem* rate of RM5 for each RM1,000, or a part thereof, but the stamp duty payable in relation to a loan denominated in foreign currency will be capped at RM500.

Where the loan agreement has been duly stamped as discussed above, the ancillary documents securing the loan may generally be stamped with nominal duty of RM10 (Section 4(3) of the SA).



4. How long, following acquisition of a foreign target company, would it usually take in Malaysia for a Malaysian subsidiary of that foreign target company to grant a guarantee/ security?

Once the local subsidiary has been incorporated, it will be entitled to grant a guarantee/security. There is no requirement for any lapse of time following incorporation or completion of an acquisition before a local subsidiary can grant security. Note, however, that under Section 67 of the CA, the local subsidiary will be prohibited from providing a guarantee or security if the underlying loan is entered into for the purposes of acquiring its shares, unless any of the exceptions under the section applies. (Please see discussion under the answer to question 1 above.)

In relation to the timeline to perfect security in Malaysia, the stamping at the stamp office and registration at the High Court, where applicable, should take approximately two working days. On the other hand, BNM approval would take approximately two weeks.

Please note that a financial guarantee to be issued by a resident:

- (a) in an amount exceeding RM50 million in aggregate to secure borrowing obtained by:
 - (i) a non-resident which is not part of the resident's group of entities; or
 - (ii) a non-resident which obtains financing from any person which is not part of the resident's group of entities;
- (b) for any amount where payment in Ringgit will be made to or by a non-resident for any underlying foreign currency borrowing,

requires the approval of BNM.

Any financial guarantee exceeding RM50 million other than those that require BNM approval as set out above, must be registered within

seven working days after it is issued. However, BNM approval or the registration requirement will not apply where the financial guarantee is to secure a credit facility that has obtained the prior approval of BNM. (Please see the discussion in the answer to question 5 below.)

5. Are there any restrictions on foreign banks lending to companies in Malaysia? Are interest payments to foreign banks typically subject to withholding tax?

Restrictions on foreign banks lending to companies in Malaysia

A resident company is permitted to obtain from a non-resident. foreign currency credit facilities of up to the equivalent of RM100 million in aggregate on a corporate group basis. Foreign currency credit facilities in excess of this amount will require the prior approval of BNM before they can be extended. Among the factors that will be considered in granting approval of the credit facility is whether it will be used for productive purposes in Malaysia. This is a regulatory requirement rather than a restriction against foreign banks lending to Malaysian companies.

However, a Malaysian resident company is free to borrow any amount in foreign currency from:

- (a) a licensed onshore bank;
- (b) its resident or non-bank non-resident entities within its group of entities:30
- (c) its resident or non-bank non-resident direct shareholder;³¹ and

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³⁰ This does not apply to a non-resident special purpose vehicle which is set up to obtain borrowing from any person which is not part of the resident entity's group of entities.

³¹ This does not apply to a non-resident special purpose vehicle which is set up to obtain borrowing from any person which is not part of the resident entity's group of entities.



(d) through the issue of foreign currency debt securities to another resident.

As previously discussed, if any security/financial guarantee is granted by a Malaysian company in favor of a non-Malaysian resident to secure a foreign currency or Ringgit credit facility which has obtained the prior approval of BNM, no further approval or registration will be required for the security/financial guarantee.

Withholding tax

Section 109 of the Income Tax Act 1967 (ITA) provides that where any person is liable to pay interest derived from Malaysia to a non-resident (other than interest attributable to a business carried on by a non-resident of Malaysia), he/she shall, on paying or crediting the interest, withhold tax and pay the amount withheld to the Director General of Inland Revenue (Director General) within one month. Currently, the withholding tax rate on interest is 15% of the gross interest (in the absence of a double taxation treaty or unless otherwise varied by the Director General). If the tax is not withheld and paid to the Director General, a claim for its deduction against Malaysian income will be rejected.

Interest derived by a non-resident from the following sources in Malaysia will not be subject to withholding tax:

- (a) interest attributable to a business carried on in Malaysia by a non-resident;
- (b) interest arising from an approved loan (i.e., loans made to the Government of Malaysia or certain loans made under an application received prior to 25 October 1996);
- (c) interest derived from Malaysia and paid by a banking institution in Malaysia to a non-resident which does not have a permanent establishment there:
- (d) interest which is exempt under a double taxation treaty;

- (e) interest paid or credited to a non-resident for a year of assessment by Bank Kerjasama Rakyat Malaysia with effect from 30 August 2008;
- (f) interest (or profit or return in the case of Islamic securities) paid or credited to non-resident companies (other than interest accruing to a place of business in Malaysia of that company) in respect of;
 - (i) securities issued by the Government; or
 - (ii) Islamic securities or debentures issued in Ringgit Malaysia (other than convertible loan stock) approved by the Securities Commission (SC);
- (g) any interest or discount paid or credited to any person in respect of Islamic securities originating from Malaysia (other than convertible loan stock) issued in any currency other than Ringgit Malaysia and approved by the SC; or
- (h) income of a unit trust in respect of interest derived from Malaysia and paid or credited by any bank or financial institution licensed under the Financial Services Act 2013 and/or the Islamic Financial Services Act 2013.
- 6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Malaysia, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Takeovers in Malaysia are regulated by the Code on Takeovers and Mergers 2010 (**Code**) and Division 2 of Part VI of the Capital Markets and Services Act 2007 (**CMSA**).

Under the Code, a company that intends to make a takeover offer must satisfy certain disclosure obligations before the takeover can be effected. The offeror company must also submit an offer document to the SC for its consent. Once the SC's consent is obtained, the offeror



company must post the offer document to the board of directors and shareholders of the offeree company. Where a publicly listed company is the subject of a takeover, the company must make an announcement to Bursa Malaysia Securities Berhad that it has received a notice of an intention to make a takeover in accordance with the Code and the Listing Requirements of Bursa Malaysia.

Under Section 28 of the Code, where the takeover offer is for cash or includes an element of cash, the offeror must ensure, and the offeror's financial adviser must be reasonably satisfied, that the takeover will not fail due to insufficient financial capability of the offeror and that every offeree shareholder that wishes to accept the takeover offer will be paid in full.

Further, Section 12(6) of the Code and Paragraph 4 of Schedule 1 of the Code require the offer document to contain a statement to the effect that the offeror and the offeror's financial adviser are satisfied that the above conditions will be met. As a matter of practice, the investment bank making the submission to the SC will not proceed with doing so unless it is satisfied that the offeror has adequate financial resources

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Section 291(2) of the CA provides that bankruptcy law applies in respect of the rights of secured creditors if a company goes into insolvent liquidation. In general, the order of ranking of creditors is as follows:

- (a) secured creditors (e.g., persons holding a mortgage, charge or lien over the company's property);
- (b) unsecured creditors given priority under Section 292 of the CA; and

(c) other unsecured creditors.

Under Section 292, the order of priority is as follows (note that these cannot be contracted out of):

- (a) first, the costs and expenses of the winding up including the taxed costs of a petitioner payable under Section 220, the remuneration of the liquidator and the costs of any audit carried out under Section 281:
- (b) second, all wages or salaries (whether earned wholly or in part by way of commission) including any amount payable by way of allowance or reimbursement under any contract of employment or award or agreement regulating conditions of employment of any employee not exceeding RM1,500, or such other amount as may be prescribed from time to time, whether for time or piecework in respect of services rendered by him/her to the company within a period of four months before the commencement of the winding up;
- (c) third, all amounts due in respect of worker's compensation under any written law relating to worker's compensation accrued before the commencement of the winding up;
- (d) fourth, all remuneration payable to any employee in respect of vacation leave or, in the case of his/her death, to any other person in his/her right, accrued in respect of any period before the commencement of the winding up;
- (e) fifth, all amounts due in respect of contributions payable during the 12 months next before the commencement of the winding up by the company as the employer of any person under any written law relating to employees' superannuation or provident funds or under any scheme of superannuation or retirement benefit which is an approved scheme under the federal law relating to income tax; and



(f) sixth, the amount of all federal tax assessed under any written law before the date of the commencement of the winding up or assessed at any time before the time fixed for the proving of debts expires.

The debts in each class specified above rank in the order specified. Debts of the same class, however, rank equally between themselves, and will be paid in full unless the property of the company is insufficient to meet them, in which case they will abate in equal proportions between themselves. Note that insurance debts owed to third parties will take priority over debt holders under Section 292 where the insurance contract is entered into before the commencement of the winding up.

From the above, it is clear that debt holders (e.g., creditors) are given priority over equity holders.

8. Is interest on debt incurred to acquire a company in Malaysia deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Interest on debt incurred to acquire a company is deductible from earnings for tax purposes, if the debt is incurred for the purpose of generating the company's income and the company intended to utilize the money for that purpose. However, once thin capitalization rules come into effect, as discussed below, excess interest costs will not be tax-deductible.

With effect from 1 January 2009, thin capitalization and transfer pricing provisions have been introduced in the ITA. Section 140A(4) of the ITA provides that where the value of all financial assistance to an associated person is excessive in comparison to the fixed capital of the recipient of the financial assistance, the interest, finance charge or other consideration payable on the excessive value shall not be deductible.

The Ministry of Finance has announced that a formal legislative regime for thin capitalization is scheduled to come into force by 31 December 2015.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Malaysia?

While a Malaysian court is likely to uphold a contractual arrangement purporting to create an effective subordination of claims, this may not always be the case in the event of the insolvency of the Malaysian company. In particular, it is possible that a Malaysian court will refuse to give effect to the contractual arrangement if it determines that to do so will be contrary to public policy or will otherwise prejudice or adversely affect the rights of other creditors of the bankrupt Malaysian company.

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Mexico

 Is there any prohibition on a company incorporated in Mexico providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

There are no specific rules or legal provisions in Mexico expressly prohibiting this type of financial assistance, although the giving of this type of financial assistance is uncommon in practice. A Mexican target company usually provides financial information to a potential buyer of its shares, or the shares of its parent company (either direct or ultimate), but does not normally provide financial advice or financial assistance to the potential buyer. Notwithstanding this, the convenience of providing financial assistance to the potential buyer should be assessed on a case-by-case basis, and if convenient, it could be done as long as the bylaws of the Mexican company allow it.

There are certain financial assistance activities that can only be undertaken by banks and financial institutions in Mexico, although those activities may not be relevant to most transfers of shares in Mexico

2. What are the implications under the corporate benefit laws of Mexico for a company providing financial assistance?

The Mexican General Law of Commercial Companies (General Law of Commercial Companies) establishes that the business operations and activities of a Mexican commercial company must be carried out in accordance with the company's corporate purposes, as established in its bylaws. Therefore, as long as the bylaws of the relevant commercial company do not establish restrictions or prohibitions on providing financial assistance to a potential buyer of its shares, or the shares of its parent company (either direct or ultimate), the company will be entitled to enter into agreements to provide financial assistance. Those agreements should facilitate business or financing

opportunities that would enable the company to comply with its business purposes and objectives as provided in its bylaws.

Although it is not mandatory under the General Law of Commercial Companies, it would be useful to have a shareholders' meeting approving the execution of, and compliance with, the agreements in relation to the financial assistance by the company, specifically for the potential buyer to proceed with the acquisition of the company's shares or the shares of its parent company (either direct or ultimate), and to have the corresponding shareholders waive their preferential rights to acquire the shares of the company that are to be sold to the potential buyer.

The General Law of Commercial Companies provides that the sole director or the board of directors of a company must act according to the provisions of its bylaws, and based on the decisions/instructions of the shareholders' meetings, always act with prudence, diligently and considering the business of the company as if it was their own. Therefore, once the shareholders have approved the execution of, and compliance with, the agreements in relation to the financial assistance by the company, the sole director of the board of directors could execute the financial assistance agreement on behalf of the company, unless of course the shareholders have designated another representative or officer of the company to execute the financial assistance agreement.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

A description of the types of security that are typically granted over shares and assets of the Mexican target company are set out below.



Pledge

A pledge is a security interest that can be granted over movable assets, rights, shares, quotas, personal property such as machinery and equipment, accounts receivable, negotiable instruments, and future products from real property, for the purpose of securing the performance of an obligation and its priority for payment. The pledge can be commercial or without transfer of possession.

Commercial pledge

For the commercial pledge to be perfected, the assets pledged must be delivered physically, virtually or legally to the beneficiary of the pledge or to a depositary appointed by the parties in the corresponding pledge contract. The commercial pledge must be executed in writing, and in the case of a commercial pledge over shares, it must also be recorded in the shareholders' registry book of the company and optionally in the electronic database of the Sole Securities Registry (**RUG**).

Pledge without transfer of possession

A pledge without transfer of possession does not require the delivery of the shares, quotas or assets. It must, however, be executed in writing and must be ratified before a notary public and recorded in the electronic database of the RUG.

Mortgage

According to Article 2893 of the Federal Civil Code, a mortgage is a right *in rem* granted over real or personal property for the purpose of securing the payment or performance of an obligation, as well as its priority for payment. Mortgages over real property, industrial mortgages, mortgages on ships and vessels and mortgages on aircrafts are only valid if they are formalized by means of a public instrument. They become effective in relation to third parties once they are recorded in the Public Registry corresponding to the mortgaged assets.

Guaranty trust

By means of a guaranty trust agreement, the settlor conveys certain assets comprised of real and/or personal property to an institution duly authorized by the federal authorities to act as trustee, with the purpose of securing the payment and priority of an obligation. On default, the trustee has the right to dispose of the trust's assets in order to satisfy the principal obligation in favor of the beneficiary. The guaranty trust needs to be granted in a public instrument or be ratified before a notary public, depending on the type of assets and the value of the trust. If the trust's assets are real property, the guaranty trust must be recorded in the Public Registry corresponding to the location of the real property. If the trust's assets are movable assets, the guaranty trust must be recorded in the electronic database of the RUG.

Fixed assets and working capital financing

This type of financing includes specific provisions by which the borrower has the obligation to use the proceeds from the credit facilities only for business or production purposes. The assets purchased with these proceeds are automatically subject to a lien in favor of the lender. This type of financing needs to be granted by written contract, ratified before a notary public and recorded in the electronic database of the RUG.

Bond

A bond is a security given by a third party in an agreement under which an individual, a legal entity, or a bond company agrees to pay the obligation of a debtor in another agreement on the occurrence of default. A commercial bond is considered to be a negotiable instrument and must be granted in written form. A civil bond does not need to be in a specific form if the terms are clear between the parties.

Duty

Mexico does not have a stamp duty or equivalent tax. No duty or tax will be payable on execution or enforcement of the securities



described above, except when the state where the assets are located establishes the payment of local taxes for the recording of security over those assets. This should be reviewed on a case-by-case basis.

4. How long, following acquisition of a foreign target company, would it usually take in Mexico for a Mexican subsidiary of that foreign target company to grant a guarantee/ security?

The length of time for the subsidiary of the acquired company to grant a guarantee/security varies, depending on the formalities that need to be complied with for the type of guarantee/security to be validly granted, including in some cases, its recording with government public registries. Please find below information about the usual approximate time frame for the granting of the guarantee/security described below.

Mortgage

The time frame for the preparation and negotiation of a mortgage varies depending on the complexity of each transaction although it is generally expected that it would take approximately seven to ten business days to prepare, negotiate and execute a mortgage. After the mortgage has been executed and formalized, the time frame for its registration will vary depending on the type of mortgage (whether over real estate property, aircrafts or vessels or whether an industrial mortgage, among others) because the type of mortgage determines the Public Registry at which it should be recorded. For example, a mortgage over real property needs to be recorded in the Public Registry of Property that corresponds to the domicile where the real property is located. There are substantial differences between the different locations in Mexico, and the time frame to record the mortgage should be assessed on a case-by-case basis as it will vary depending on the workload of each particular Public Registry Office.

Pledge

Commercial pledge

The time frame for the preparation and negotiation of a commercial pledge varies depending on the complexity of each transaction although it is generally expected that it would take approximately seven to ten business days to prepare, negotiate and execute a commercial pledge. After the commercial pledge has been executed and formalized, the approximate time for its registration in the electronic database of the RUG is one to two business days. For a share pledge, the approximate time for its registration in the shareholders' registry book of the corresponding company is one to two business days.

Pledge without transfer of possession

The time frame for the preparation and negotiation of a pledge without transfer of possession varies depending on the complexity of each transaction although it is generally expected that it would take approximately ten to fifteen business days to prepare, negotiate and execute a pledge without transfer of possession. After the pledge without transfer of possession has been executed and formalized, the approximate time frame for its registration in the electronic database of the RUG is one to two business days.

Guaranty Trust

The time frame for the preparation and negotiation of a guaranty trust varies depending on the complexity of each transaction although it is generally expected that it would take approximately fifteen to thirty business days to prepare, negotiate and execute a guaranty trust. After the guaranty trust has been executed and formalized, the time frame for its registration, if it was granted over real property, will depend on the workload of the particular Public Registry of Property where the real property is located. In the case of a guaranty trust over movable assets, its recording in the electronic database of the RUG would take from one to two business days.



Fixed assets and working capital financing

After the fixed assets and working capital financing has been executed and formalized, the approximate time for its registration in the RUG is one to two business days.

Bonds, joint obligations and Unconditional Guaranty Endorsement (*Aval*)

The time frame for the preparation and negotiation of bonds, joint obligations and an unconditional guaranty endorsement (*aval*) varies depending on the complexity of each transaction although it is generally expected that it would take between one and four business days to prepare, negotiate and execute these documents.

Bonds, joint obligations and unconditional guaranty endorsements do not require registration.

5. Are there any restrictions on foreign banks lending to companies in Mexico? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

There are no mandatory approvals, permits or filings required for a loan agreement entered into between a foreign lender and a domestic borrower to be valid and enforceable in Mexico.

Tax

Interest payments are subject to withholding tax when they are paid to non-residents of Mexico. Mexican income tax is calculated by applying a rate that ranges from 4.9% to 21% with no deduction to any interest obtained by a non-resident (depending on the type of entity that receives the interest) and is withheld and paid to the tax authorities by the person (the Mexican entity) making the payments of interest.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Mexico, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

There are no requirements regulating the availability of bank debt for public tender offers in Mexico. However, the terms of the debt must be disclosed to the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*) (**CNBV**) when approval is requested to make a tender offer, as explained below.

The Mexican Securities Law (*Ley del Mercado de Valores*) (**Law**) and the Sole Issuers' Guidelines (*Circular Única de Emisoras*) (**Circular**) provide the general requirements with which a party wishing to acquire a participation in a public company in Mexico (**Issuer**) must comply. The main requirements are as set out below.

Tender offer

The party that intends to acquire, directly or indirectly, participation lower than 30% of the shares of the Issuer is required to do so by a voluntary public tender offer on the terms required by the Law. That tender offer must be circulated to the holders of all shares of the Issuer on the same terms and conditions and it must disclose all covenants or undertakings agreed on with the Issuer or with certain holders of shares of the Issuer.

Before circulation to the holders of all shares of the Issuer the terms of the tender offer must have been approved by the CNBV under the procedure described below. The offer must be in effect for an initial period of 20 business days and it may be amended at any point to the extent the terms offered for the purchase of the shares are more favorable to the intended sellers. If the amended terms warrant the period of the tender offer being extended, the CNBV may require an extension of time



Once the tender offer is agreed to and made, the offeror may not acquire any shares "outside the offer." The tender offer is permitted to be conditional on the acquirer being able to acquire a certain number of shares of the Issuer.

Tender offer documents

The party that intends to acquire, directly or indirectly, participation lower than 30% of the shares of the Issuer is required to do so by way of the following information and documentation:

- (a) Exhibit A-1: Written request to the CNBV;
- (b) Exhibit B: List of documentation and information to be attached to Exhibit A-1; and
- (c) Exhibit K: Instructions to prepare an informative brochure for public tender offers.

The information and documentation that must be included by the offeror in the above exhibits are:

- (a) the general information of the offeror and Issuer;
- (b) the power of attorney of the person representing the party requesting the tender offer;
- (c) a copy of the minutes of the meeting of shareholders and resolutions of the board of directors of the offeror, certified by the Issuer's secretary authorizing the public tender offer;
- (d) a draft of the contract to be entered into with the stock brokerage (intermediary) for the transaction;
- (e) a draft of the public tender offering notice with the information contained in the cover of the brochure;

- (f) a copy of the agreements entered between the purchasers of the shares and the shareholders or directors of the Issuer;
- (g) an opinion by an independent expert regarding the fairness of the price offered for the shares;
- (h) information on the securities market where their stock is traded;
- (i) the intent and justification of the offer;
- (j) the source and amount of the resources used for paying for the shares;
- (k) the right to refuse to accept the offer by the shareholders;
- (l) an opinion by the board of directors and, as appropriate, an independent expert; and
- (m) the tax treatment of the offer.

Requirements for approval of a Public Tender Offer

According to the Law, on the filing of all of the information and documents required for the approval of a public tender offer, the CNBV must respond within a period of three months. However, the Circular provides for the offerors to initiate the procedure at least 20 business days prior to the date scheduled for the public tender offer. In practice, the response time depends on the workload of the CNBV at the time of the request. Filing fees must be paid for this formality.

The terms and conditions of the tender offer will be disclosed widely to the holders of the shares through the informative brochure (Exhibit K) (once it has been approved by the CNBV).

In general terms, the public tender offer of shares will remain in force and effect for a minimum term of 20 business days. The characteristics of the offer may be amended prior to its conclusion in some cases. When, in the opinion of the CNBV, the amendments are



relevant, the time period of the offer must be extended for a minimum of five additional business days.

Additional requirements if acquiring more than 30% of shares

A party that intends to acquire directly or indirectly participation higher than 30% of the shares of the Issuer is required not only to comply with the requirements listed above, but also to comply with the following requirements:

- (a) the offer will be extended to the different series of shares of the Issuer, including those of limited voting shares, restricted voting shares or non-voting shares;
- (b) the consideration offered must be the same, regardless of the class or type of share;
- (c) the offeror must also disclose, if applicable, the commitments or agreements held in terms of the provisions of Article 100 of the Mexican Securities Market Law (which prohibits payment of an overprice or price premium), entered into with the Issuer or with the holders of the securities that the offeror is seeking to acquire;
- (d) the offeror must also acquire:
 - (i) the percentage of ordinary share capital of the Issuer equal to the proportion of the ordinary shares the offeror wishes to acquire, or 10% of the capital, whichever result is greater, as long as the percentage of shares owned by the offeror (*tenencia*) after the offer, is a percentage that does not grant control over the Issuer; or
 - (ii) 100% of the stock capital when it is the offeror's intention to own all of the shares in the company; and
- (e) the offer must state the maximum number of shares to which it extends and, where appropriate, the minimum number of shares required to be acquired for the offer to proceed.

If the relevant offer will result in the acquisition of 100% of the share capital of the Issuer, it will be subject to be the provisions of Article 89, Section I of the General Law of Commercial Companies.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Under the Mexican Insolvency and Bankruptcy Law (*Ley de Concursos Mercantiles*) the obligations of an insolvent debtor will be paid in the following order of priority.

Creditors/debts in relation to the estate

Creditors or debts in relation to the estate are:

- (a) salaries owed to employees for the past two years that are to be paid before any other claim;
- (b) debts related to the management of the estate that are contracted by the merchant with the authorization of the "Conciliator" or "Trustee" or, credits contracted by the "Conciliator";
- (c) debts owing to cover ordinary expenses related to the security of the assets of the estate, its replacement, conservation and administration;
- (d) debts originated from in court or out-of-court procedures for the benefit of the estate; and
- (e) the fees of the "Visitor", "Conciliator" and "Trustee".

Uniquely privileged creditors

Uniquely privileged creditors only exist in the event of the insolvency of an individual debtor who has died (funeral expenses of the debtor and expenses associated with the illness that has caused the death of the debtor).



Mortgages and pledges

Creditors with *in rem* guarantees (security interests), mortgages and pledges, have next priority as long as their security is duly established in accordance with the applicable provisions. They will receive repayment of their loans from the assets attached to the security subject to the order determined in accordance with the applicable provisions regarding the date of registration.

If the secured property is sold, the secured creditor can recover its money first (subject to bankruptcy expenses and any remaining sale proceeds belonging to the bankruptcy estate). If the sale proceeds are not sufficient to cover the debt in full, the creditor can claim the outstanding amount as an unsecured creditor.

Creditors with special privilege

Creditors with special privilege, i.e., all those that, according to the Law, have a special privilege or a right of withholding have next priority. For example, the builder of any movable work is entitled to withhold it until it is paid, and its claim will be preferably paid from the value of that asset.

Common/unsecured creditors

Common creditors or unsecured creditors whose claims will be paid *pro rata* regardless of the dates of their claims are last in the order of priority.

Other rules

The law further states that all tax and labor claims are to be paid after the secured creditors, but before creditors with special privilege. The law sets out one exception, i.e. the salaries owed to employees for the past two years are to be paid before any other claim, including those of secured creditors Shareholders may retain equity even though recognized creditors are not paid in full where the requisite approval of the reorganization plan is obtained ³²

8. Is interest on debt incurred to acquire a company in Mexico deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Interest payments on debt used to fund an acquisition are taxdeductible in Mexico. Therefore, acquisition through financial mechanisms is a valid option from a tax standpoint.

There are thin capitalization rules in Mexico. In essence, the rules disallow the deduction of interest corresponding to debts with non-resident related parties, when the total amount of all debts generating interest exceeds three times the taxpayer's book net worth.

Therefore, although there are no limits from a commercial, corporate or even tax perspective on the amount of the loan, in the latter case, thin capitalization rules must be observed at a 3:1 debt-equity ratio in order for the interest on the loan to be tax-deductible.

These rules, however, do not apply to entities that operate in the financial system, if those debts are taken on for the purpose of funding their banking/lending business.

³² A reorganization plan is proposed and filed by the Conciliator. In order for the plan to be effective, it must be signed by the debtor and by recognized creditors representing over 50% of the sum of: a) the recognized amount of all of the regular recognized creditors; and b) the recognized amount of the recognized creditors having a collateral or special privilege that sign the agreement. A reorganization plan must be approved by the court.



9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Mexico?

The Mexican Insolvency and Bankruptcy Law prescribes the order of priority in which the obligations of the debtor must be paid (see the answer to question 7). Therefore, the bankruptcy trustee will refuse to recognize a contractual subordination that is not consistent with the order of priority prescribed under the Mexican Insolvency and Bankruptcy Law.

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Netherlands

1. Is there any prohibition on a company incorporated in the Netherlands providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Prohibition against giving financial assistance applies to a public company

A distinction must be made between the acquisition of shares held in the capital of a Dutch public company with limited liability (*naamloze vennootschap*) (**N.V.**) and the acquisition of shares held in the capital of a Dutch private company with limited liability (*besloten vennootschap*) (**B.V.**).

Currently, under Dutch law, the financial assistance prohibition is only applicable when dealing with N.V.s.

Prohibition against giving financial assistance does not apply to a private company

By legislative changes in Dutch company law effective from 1 October 2012, the prohibition on financial assistance in connection with the acquisition of shares held in the capital of a B.V. has been abolished.

Details of the prohibition against giving financial assistance

Under Article 98c of Book 2 of the Dutch Civil Code (*Burgerlijk Wetboek*) (**DCC**), an N.V. may not provide security (collateral), give a share price guarantee, vouch for third parties in any other way or make itself jointly and severally liable for a third party's debt in addition to, or instead of, that third person or otherwise, with a view to the subscription, payment of or acquisition of any of the shares in the N.V. (or depositary receipts issued for those shares), or to refinance any indebtedness incurred for the subscription or acquisition of its



shares by others. This prohibition also applies to an N.V.'s subsidiaries, both domestic and foreign.

Financial assistance in the form of a loan can qualify for an exemption if certain conditions are met

Under the financial assistance prohibition, an N.V. and its subsidiaries are also prohibited from granting loans for the purpose of a subscription for, or the acquisition of, its own shares (or depositary receipts for those shares) by others, unless the board of managing directors (*bestuur*) of the N.V. has resolved to do so and the following requirements are met:

- (a) the granting of the loan, including the interest received by the N.V. and the securities provided to the N.V., are made under fair conditions (*billijke marktvoorwaarden*);
- (b) the N.V.'s equity (total assets minus liabilities) according to the last adopted balance sheet, reduced by the amount of the granted loan, is not less than the paid up and called up share capital plus the reserves which must be maintained by law or the articles of association (*statuten*) if the N.V.'s annual accounts have not been adopted more than six months prior to the granting of the loan;
- (c) the creditworthiness (solvency) of the third party or, if it concerns an agreement between more than two parties, of each involved party, has been carefully examined;
- (d) if the loan is granted for the purpose of a subscription for shares in connection with an increase of the issued share capital of the N.V. or for the purpose of obtaining shares in the N.V.'s capital that are held by the N.V. itself, the price for which the shares are taken or acquired must be fair.

When granting a loan in accordance with the requirements set out above, an N.V. must maintain a non-distributable reserve equal to the amount of the granted loans.

A resolution of the board of managing directors to grant a loan as referred to above, is subject to the prior approval of the N.V.'s general meeting of shareholders (*algemene vergadering*). If shareholders with less than 50% of the issued share capital are represented at the meeting, a resolution of the general meeting approving the loan must be taken by a majority of at least two-thirds of the votes cast.

For an N.V. whose shares are admitted to trade on a regulated market or a multilateral trading facility as defined in Article 1:1 of the Dutch Financial Supervision Act (*Wet op het financieel toezicht*) (**FSA**), the resolution has to be passed by a majority of at least 95% of the votes cast. When the approval is requested of the general meeting, this will be reported in the convening notice for that general meeting. Together with the convening notice, a report is deposited at the trade register office of the chamber of commerce (*kamer van koophandel*) for inspection by the shareholders and the holders of depository receipts with meeting rights. That report must set out the reasons for granting the loan, the interest in that transaction for the N.V., the terms and conditions on which the loan will be granted, the price for which the shares will be taken or acquired by the third party, and the risks connected to the loan in relation to the liquidity and solvency of the N V

Exceptions

The financial assistance rules laid down in Article 98c of Book 2 of the DCC do not apply to:

- (a) transactions where shares or depositary receipts for shares are taken or acquired by or for employees of the N.V. or employees of a group company; or
- (b) a licensed bank.



Contravening acts void

It is generally considered by legal scholars in the Netherlands, that any legal act that contravenes the rules on financial assistance is considered void (*nietig*).

2. What are the implications under the corporate benefit laws of the Netherlands for a company providing financial assistance?

If an N.V. or B.V. (or its subsidiaries) intends to provide financial assistance (in the form of a loan as discussed above or by granting security), the relevant Dutch company must ensure that:

- (a) it derives a corporate benefit from the obligation for which the financial assistance is provided; and
- (b) the company's existence is not threatened by the provision of the financial assistance.

In general, a company will be deemed to benefit from the provision of financial assistance if a strong financial and commercial interdependence exists between the company and the other (future) group members for which financial assistance is given and the company's existence is not expected to be endangered by providing the financial assistance. In other words, a hypothetical assessment must be made about the company's financial and commercial position as if financial assistance were given. If and to the extent there appears to be an imbalance between the commercial benefit gained by the company and the detriment it would suffer if the financial assistance was called on, the company (or the trustee in bankruptcy) will be able to contest the validity of the financial assistance under the corporate benefit rules.

This will be the case irrespective of the wording of the objects clause (*doelomschrijving*) in the articles of association of the N.V. (or relevant subsidiary), although the objects clause is an indication of the

possibility of granting loans or security for the benefit of others rather than for the benefit of the company itself.

There is no unanimous view in Dutch legal doctrine, however, in relation to the benefit required. Therefore, it cannot be ruled out that (following the hypothetical assessment), even if there is a strong financial and commercial interdependence, a transaction might be declared void by the Dutch courts if it is evident that the transaction cannot serve the realization of the company's objects. In light of the above, it is advisable to include wording in the recitals of the financial assistance agreements that explicitly refers to the economic and commercial benefits for the company in entering into the relevant agreement, as well as to reflect this in the corporate authorizations of the companies entering into the financial assistance agreements.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

A short overview of the different types of security interests that may be granted in the Netherlands and the technical requirements for each of them is set out below. These security interests are divided into security interests effected by means of private deed (*onderhandse akte*) and security interests effected by means of notarial deed (*notariële akte*).

Private security interests

Trade receivables

Trade receivables will generally be pledged by way of a private deed of undisclosed right of pledge (*stil pandrecht*), which needs to be registered with the relevant tax authority (being the tax authorities in Rotterdam, the Netherlands) to constitute a valid right of pledge under Dutch law. Registration does not have tax consequences.



Notice of an undisclosed pledge is commonly not sent to the relevant trade debtors until an acceleration event occurs. After an acceleration event, the pledgee may give notice to the relevant trade debtors that they can only discharge their obligations by payment to the pledgee. By only giving notice and therefore disclosing the right of pledge once an acceleration event occurs, the pledgor's right to deal with its customers is not affected until the notice is given. After receiving notice that an acceleration event has occurred, the trade debtors must pay their debt to the pledgee and are no longer free to pay to the pledgor.

The list of trade receivables subject to the pledge should be updated on a regular basis. New receivables need to be pledged by way of a supplemental deed of pledge on a regular basis, to secure any future receivables not arising from a legal relationship existing at the time the original right of pledge is granted. There is no strict policy on the required regularity, although a quarterly basis for trade receivables is considered to be the minimum, depending on the type of business. Dutch banks in secured financings generally create pledges over a bank debtor's new trade receivables on a daily basis under a power of attorney.

Bank accounts

The monies held in bank accounts will generally be pledged by way of a private deed of disclosed right of pledge (*openbaar pandrecht*), under which notice to the account bank is required to constitute a valid right of pledge under Dutch law. These notices should also be acknowledged by the bank where the account is held as that bank is a debtor of the bank account receivables.

This notice generally also contains a request for a waiver by the Dutch bank where the bank account is held of its first ranking right of pledge and right of set-off that it has by means of the Dutch general banking conditions (*algemene bankvoorwaarden*) in favor of the pledgee. Further, additional general terms and conditions for Dutch account banks customarily contain a restriction on the right to create a security

right over the bank account receivables. That restriction must be lifted by the account bank for a valid right of pledge.

After an acceleration event, the pledgee may give notice to the relevant account bank to only pay monies in relation to the bank account receivables to the pledgee and that it is no longer free to pay to the pledgor.

The list of bank accounts is updated on a regular basis. Deeds of pledge generally require that any additional bank accounts (including bank accounts held at additional banks) are subject to a right of pledge as soon as they are opened. A right of pledge granted over bank accounts only extends to the receivables in that bank account(s) on the day the right of pledge is granted. It does not extend to each subsequent crediting of the bank account. To remedy this, it is commonly agreed that each crediting of a bank account is deemed to constitute a new right of pledge.

Inter-company receivables

Inter-company receivables will generally be pledged by way of a private deed of a disclosed right of pledge under which notices to the intra group debtors are required to constitute a valid right of pledge under Dutch law.

After an acceleration event, the pledgee may give notice to the relevant intra-group debtors that they can only pay monies in relation to the inter-company receivables to the pledgee and are no longer free to pay to the pledgor.

The list of inter-company receivables should be updated on a regular basis. Deeds of pledge generally require that any additional inter-company receivables (including inter-company receivables in relation to additional intra-group debtors) are made subject to a right of pledge as soon as they arise. There is no strict policy on this matter, although a quarterly basis for inter-company receivables is considered to be the minimum.



Insurance receivables

Insurance receivables will generally be pledged by way of a private deed of a disclosed right of pledge by which notices to the underwriters and/or insurance companies are required to constitute a valid right of pledge under Dutch law. These notices should also be acknowledged by the underwriters and/or insurance companies as debtors of the (potential) insurance claims.

After an acceleration event, the pledgee may give notice to the relevant underwriters and/or insurance companies to only pay monies in relation to the insurance to the pledgee and that it is no longer free to pay to the pledgor.

The list of insurance receivables should be updated on a regular basis and deeds of pledge generally require that any additional insurance receivables (including insurance receivables on additional underwriters and/or insurance companies) are subject to a right of pledge as soon as they are entered into. There is no strict policy on this matter, although a quarterly basis for insurance receivables is considered to be the minimum.

Movable assets

Movable assets will generally be pledged by way of a private deed of a non-possessory right of pledge (*bezitloos pandrecht*), which needs to be registered with the relevant tax authority (being the tax authorities in Rotterdam, the Netherlands) to constitute a valid right of pledge under Dutch law.

The list of locations (in the Netherlands) where movable assets are held should be updated on a regular basis. There is no strict policy on this matter, although a quarterly basis for movable assets is considered to be the minimum.

Intellectual property

Intellectual property will generally be pledged by way of a private deed of a disclosed right of pledge, which needs to be registered with

the relevant intellectual property right registration office to constitute a valid right of pledge under Dutch law.

As the registers of the intellectual property registration office are publically accessible, it is common to register a pledge confirmation of the existence of the right of pledge only and not the entire deed of pledge itself, in order to avoid disclosing more information to the public than strictly required.

The list of intellectual property should be updated on a regular basis and deeds of pledge generally require that any additional intellectual property is subject to a right of pledge as soon as it is created or registered. There is no strict policy on this matter, although on an annual basis for intellectual property rights is considered to be the minimum.

General

The private security interests listed above may, in practice, be combined in one private omnibus deed of pledge covering the different types of assets. Although the granting of these private security interests is most commonly done by means of private deeds, these security interests may also be granted by means of a public notarial deed executed by a Dutch civil-law notary.

Notarial security interests

Shares

Shares will be pledged by way of a notarial deed of disclosed right of pledge executed before a Dutch civil-law notary. This can be done in a matter of days provided that the title deeds (*aankomsttitels*) are available, the shares are unencumbered and the shareholders' register is available, complete and up-to-date and does not reveal impediments.

The notarial deed of pledge will be executed before a Dutch civil-law notary based on notarial powers of attorney for the pledgor, the



pledgee and the company in which the shares are being pledged. Registration of the right of pledge in the pledged company's shareholders' register (aandeelhoudersregister) is required to invoke the right of pledge against third parties. Under a deed of pledge, generally the voting rights in relation to the shares are conditionally transferred to the pledgee subject to the occurrence of an acceleration event.

The shares in the capital of a B.V. will be registered in the name of the shareholders (aandelen op naam). A B.V. may not issue bearer shares (toonderaandelen). The shares held in the capital of a N.V. may consist of either registered shares, bearer shares or, in the case of listed shares, book-entry securities (global or specific certificates).

If a right of pledge of shares is to be granted over registered shares, when the deed of pledge is effected, the shares will not be physically transferred to the pledgee but the right of pledge will be registered in the name of the pledgee in the shareholders' register of the company.

A right of pledge over book-entry securities will not be granted by means of Dutch notarial deed of pledge. Under Dutch law, registration and perfection of a right of pledge would consist of procuring the entry (bijschrijving) of the right of pledge as set out in Article 20 of the Giro System Act (Wet Giraal Effectenverkeer) by sending a notification (mededeling) to the relevant securities intermediary, with a copy to the pledgee, and provide to the pledgee evidence of:

- (a) the notification; and
- (b) the entry of the right of pledge.

Immovable property

Immovable property will be made subject to a right of mortgage (hypotheek) by way of a notarial deed of mortgage executed before a Dutch civil-law notary. This can be done in a matter of days provided that the title deeds are available, the immovable property is

unencumbered and the cadastral review (*kadastrale recherche*) does not reveal impediments.

The notarial deed of mortgage will be executed before a Dutch civillaw notary based on notarial powers of attorney for the mortgagor and the mortgagee. Registration with the land registry (*kadaster*) by the notary is required to constitute a valid right of pledge under Dutch law

General

The powers of attorney required for each of the above-mentioned notarial security interests must be notarized and apostilled if they relate to foreign entities.

Registration/Tax

Other than set out above, it is not necessary under the laws of the Netherlands to file, register or otherwise record in any public office or elsewhere in the Netherlands to ensure the legality, validity, enforceability or admissibility in evidence of the security interest or other related documents.

No stamp duty, registration tax or similar documentary tax or charge is required to be paid in the Netherlands in respect of the execution and delivery of the security interests set out above.

4. How long, following acquisition of a foreign target company, would it usually take in the Netherlands for a Ditch subsidiary of that foreign target company to grant a guarantee/security?

General

There is no statutory period governing the length of time before a Dutch local subsidiary can grant a guarantee/security. The length of time depends on the number of Dutch target subsidiary companies involved and the group structure, including whether any Dutch target



subsidiary is a public company or even a listed public company. A listed public company may have statutory thresholds of shareholder approval that need to be obtained.

Generally, the quickest period in which a Dutch subsidiary can provide a guarantee or security is a few days only (or in some instances even a single day) from the acquisition. However, this strict timing assumes that:

- (a) there is a reference in the objects clause of the Dutch entity's articles of association in relation to the entering into of a guarantee or other security interest by the Dutch entity. This may serve as an indication that the entering into of a guarantee or other security interest is in the best interests of the company and that no amendment to the articles of association is required as an amendment may take a couple of days depending on the availability of Dutch civil-law notaries;
- (b) the corporate authorizations required for the entering into of the guarantee or other security are obtained on the date of acquisition and those corporate authorizations are obtained by means of resolutions outside a formal meeting. If the decision-making process can only take place by means of formally convening a meeting, a minimal convocation period of 15 days may be applicable. This may be extended to a formal convocation period of 60 days where a listed public company is involved. Although the entering into of a guarantee or other security interest may still be valid if no corporate authorization is obtained, it is common to have corporate authorizations in place;
- (c) all perfection and registration requirements are lodged on the date of acquisition; and
- (d) there is no works council involved in relation to the company granting security (or if there is a right of pledge over shares only, no works council is present with the company whose shares are being pledged).

Works Council Act

Under the Dutch Works Council Act (WCA), an entrepreneur (*ondernemer*) (being the private individual or legal entity running the business) of a company that in general employs 50 or more employees, must set up a works council. The WCA obliges the entrepreneur of the relevant company to seek the prior advice of the works council in relation to certain matters.

The advice must be in writing and must be requested within a time frame, which will allow the works council to have a reasonable impact on the decision to be made (Article 25(2) of the WCA). The request for advice must be accompanied by an explanation of the reasons for the contemplated decision, and the expected consequences for the labor force of the enterprise (if any). There is no set time frame within which the works council must grant its advice, although a waiting period ranging between three weeks and one month and a half is considered standard

Proposed decisions that might influence the continuation of the company and the labor force of the company and that to be advised on include:

- (a) the transfer of voting rights in the company or a part of those voting rights (including a conditional transfer of voting rights to a pledgee under a right of pledge); and
- (b) the granting of a major credit and the granting of security for major debts of another enterprise, unless the same is effected as part of the enterprise's normal business conduct.

The granting of the security interests (such as share pledges) and the entering into of the guarantee falls under these provisions, because the security interests granted by the Dutch subsidiary are granted for a debt that its (indirect) parent will incur.



5. Are there any restrictions on foreign banks lending to companies in the Netherlands? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

Prohibition in relation to repayable funds

The FSA prohibits anyone in the Netherlands from attracting, obtaining or having at its disposal repayable funds beyond a restricted circle (*besloten kring*) in the pursuit of a business from other parties other than the so-called professional market parties (*professionele marktpartijen*). This applies to all private individual and companies in the Netherlands. The Dutch Authority for Financial Markets (**AFM**) considers Dutch persons or companies to be active on the Dutch market when they attract repayable funds from companies in the Netherlands, but also when they attract repayable funds from companies outside the Netherlands.

Further, the AFM also considers foreign companies attracting money from companies in the Netherlands to be taking place on the Dutch market and, therefore, in the Netherlands. Therefore, if a Dutch company lends money to a company established outside the Netherlands, this would also qualify as attracting repayable funds from within the Netherlands.

Under the FSA, any funds that must be repaid, for whatever legal reason, qualify as "repayable funds", if it is clear beforehand what the nominal repayable amount is and in what manner any applicable compensation (such as interest) is to be calculated. The definition of "repayable funds" could entail more than just the borrowing of funds. For example, it is possible that monetary obligations created in the context of complex financing structures (which do not necessarily entail an obligation to repay borrowed money) may nevertheless be considered to qualify as obtaining "repayable funds" within the meaning of the FSA. Similarly, taking into account the wide scope of the term "bank" under the FSA, certain finance companies may also qualify as "banks" within the meaning of the FSA.

Exceptions

Under Dutch law, if a borrower borrows from a single lender, that lender, irrespective of its relationship with the borrower, is deemed to understand the risks involved and the Dutch regulator is of the opinion that the lender does not require protection. However, if a borrower borrows from more than one lender with whom the borrower forms a so-called restricted circle (i.e. an accurately defined group of entities, with verifiable joining criteria that have been established beforehand, containing members that already have a legal relationship with the borrower), such as a borrower's group companies, the prohibition does not apply.

Furthermore, the prohibition from attracting, obtaining or having at its disposal repayable funds does not apply when attracting those funds from "professional market parties" within the meaning of the FSA. These "professional market parties" include, among others, licensed financial undertakings, (such as banks, investment firms and undertakings for collective investment), qualified investors and certain large corporations. The Dutch rules also provide that any person who provides loans with a minimum amount of EUR 100,000 (or its equivalent in another currency) is considered to be a "professional market party" in its relationship with the borrower. In practice, the threshold amount of EUR 100,000 of loans made to any Dutch borrower is generally used in loan agreements and other financing agreements to make sure that this regulatory requirement is complied with

Taxation

The Netherlands does not levy withholding taxes on interest payments. Therefore, interest payments made to foreign banks are typically not subject to Dutch withholding taxes.

If a loan qualifies as an equity instrument for Dutch tax purposes (a so-called hybrid instrument), then interest payments on that loan are, in principle, subject to Dutch dividend withholding tax (the statutory rate of which is 15%). Depending on the tax residency and tax status



of the recipient of the interest income, the levy of Dutch dividend withholding tax may be reduced on the basis of specific Dutch tax law provisions, an applicable tax treaty or the EU Parent-Subsidiary directive.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in the Netherlands, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

The process of public takeover bids for the issued and outstanding shares of a public company, whose shares are admitted to trade on a regulated market in the Netherlands, is subject to the public takeover rules set out in the FSA and its ancillary regulations.

The FSA requires the bidder and the company to announce the takeover bid by way of a public announcement no later than the moment they have reached agreement, whether conditional or unconditional, about the launching of the takeover bid. The announcement of the takeover bid will trigger mandatory rules in terms of the timing of the takeover bid.

Under the FSA, it is prohibited to make a takeover bid for securities that are listed on a regulated market in the Netherlands, unless an offer document is made available by the bidder prior to launching the offer. This offer memorandum must meet certain specific criteria and must be approved by the AFM or by the competent supervisory authority of another European Economic Area country prior to publication. The AFM (or, if applicable, the competent supervisory authority of another European Economic Area country) will assess whether the offer memorandum contains all the information that a reasonably informed and carefully acting person must possess to form a well-considered opinion about the takeover bid.

The mandatory information to be disclosed in the offer document includes relevant information concerning the takeover bid, including but not limited to details on the financing of the takeover bid. The

FSA requires that a bidder is responsible to ensure that it can pay in full any cash consideration offered in the takeover bid (and that the bidder must have taken all reasonable measures to secure the implementation of any other type of consideration) as at the day of the filing of the request for approval of the offer document with the AFM. In practice, the certainty of funds statement is based on a commitment by the financing banks and a term sheet for financing, which may only be subject to a customary condition within the control of the bidder (such as absence of a material default by the bidder). Once the bidder has ascertained that it has certainty of funds, it is also obliged to make a public announcement about this.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

The leading principle of Dutch bankruptcy law is the *paritas creditorum* principle, which means that all creditors have an equal right to payment and that the proceeds of the bankrupt estate are distributed amongst them evenly. However, there are two main groups of creditors to which the principle of *paritas creditorum* does not apply:

- (a) creditors who hold a security interest *in rem* (such as a right of pledge or mortgage); and
- (b) creditors who have a preference by virtue of statutory law.

Secured Creditors

Creditors who hold a security interest *in rem* may exclude the collateral from the debtor's estate and enforce their rights as if there was no insolvency. The creditor is entitled to prompt foreclosure of the secured asset and to redeem his/her claim from the proceeds as if there was no insolvency.

As a result, the trustee in bankruptcy is not entitled to retain the encumbered property. As the secured creditor obtains payment of



his/her claims by executing on the security, he/she cannot be charged with bankruptcy costs (although exceptions apply). The automatic stay of all actions against the debtor, which results from an adjudication of bankruptcy (fixation), does not apply to creditors with a security right in rem. If a cooling-off period (which may be for a period of up to four months) is ordered, a secured creditor cannot remove any assets from the estate. During the cooling off period, creditors may not enforce their rights, including security rights in rem.

Furthermore, if, in relation to a pledge over receivables in relation to which notice has not yet been given, the debtors of those receivables have validly discharged their debts by making payments to the trustee in bankruptcy rather than to the pledgee, the pledgee will:

- (a) have a highly preferred claim in relation to the monies so paid;
- (b) not be able to enforce its rights as if there was no bankruptcy;
- (c) have to share in the bankruptcy costs (i.e., because a pro rata share of such costs will be payable out of the proceeds, the net proceeds received will be less); and
- (d) only receive those net proceeds at the end of the bankruptcy or when the intermediary payments (tussentijdse uitkeringen) are made

The most important secured creditors are those who:

- (a) have the right of ownership (eigendom) (e.g., through retention of title/reservation of ownership):³³
- (b) hold a right of mortgage; and

³³ A juridical act performed with the intention to transfer property merely to

provide security for a debt or performed without the intention of bringing the property into the patrimony (capital) of the acquirer is not a valid legal basis for a transfer of that property.

(c) hold a pledge.

The mortgagee and the pledgee are both entitled to auction off the collateral without the cooperation of the trustee. They are further entitled to deduct the sums owed by the bankrupt debtor from the proceeds of the auctioned property. The excess proceeds, if any, are then handed over to the trustee.

Dutch tax authorities have a right of attachment (*beslag*) not only on the assets of the Dutch company itself but also to third-party assets found on the tax debtor's premises (*bodemrecht*). This right of attachment has priority over a non-possessory (*bezitloos*) right of pledge or over a right of property of a third party over the same assets and is used to settle any outstanding tax debt before any other creditors may step in.

The trustee is entitled at all times to have the collateral released from a mortgage or a pledge by paying the mortgagee or the pledgee the amount owed by the bankrupt debtor. If the amount the debtor owes to the mortgagee exceeds the principal sum specified in the mortgage, the trustee may release the property by paying the portion of the debt attributable to the mortgage. The mortgagee must then release the collateral from the mortgage.

Preferred Creditors

There are two categories of preferred creditors:

- (a) creditors who have a statutory priority; and
- (b) creditors who have a non-statutory priority.

Most of the preferred creditors are not entitled to initiate foreclosure proceedings. They are required to present their claims to the trustee and are charged their pro rata share of the costs of the bankruptcy.



Creditors with a Statutory Priority

Preferential rights are created by specific, limited statutory provisions only. These rights create a preference in the proceeds of the liquidation (such as the right of retention). They may relate to all of the debtor's property or to specific property only. If the trustee recognizes the preference, and unless another creditor has a higher priority, the preferred creditor will be the first to receive payment from the proceeds of the collateral. The creditor who has priority over the proceeds of goods delivered by him/her should notify the trustee of his/her preference. If the creditor fails to notify the trustee before the trustee sells the goods to which the preference relates, the creditor runs the risk that his/her preference will not be acknowledged.

The preferences of the tax and social security administrations are among the highest in rank. Even after an adjudication of bankruptcy, the tax administration has the right to attach most movable property located "on the premises" of the debtor as further set out above.

Creditors with Rights which Operate as Priority

Some creditors are in the position of having a right, which *de facto* operates as a priority. The main right which enables a creditor to enforce a 'priority' right is the right of set-off.

Set-off is a means by which the debts between two parties are discharged through cross demands which cancel each other out. This right is governed by both the DCC and the Dutch Bankruptcy Act (*Failissementswet*). For the right of set-off to be used in bankruptcy, both the claim and the debt must exist before the adjudication of bankruptcy, or must originate from acts performed prior to the bankruptcy.

Unsecured Creditors

As explained above, the equality of all creditors (*paritas creditorum*) is an underlying principle of Dutch bankruptcy law. It applies to all unsecured creditors. They do not have any preference and will

therefore only be (partially) paid if any proceeds of the estate remain after all other secured or preferred creditors have received payment.

8. Is interest on debt incurred to acquire a company in the Netherlands deductible from earning for tax purposes? Are there any thin capitalization thresholds?

In general, interest expenses on unrelated/third-party debt (e.g. ,bank debt) used to finance the acquisition of a company are deductible for Dutch corporate income tax purposes. However, Dutch tax law contains several (anti-abuse) provisions which limit the deduction of interest expenses on related party debt in the case of certain tainted transactions or in the case of excessive (third party) debt financing as set out below.

Interest deduction limitation in relation to tainted transactions

Interest expenses on loans from affiliated entities or individuals may be disallowed for corporate income tax purposes if the loan is related to any of the following 'tainted transactions':

- (a) a profit distribution;
- (b) a capital contribution to an affiliated entity; or
- (c) an acquisition or increase of the shareholding in an entity that qualifies as an affiliated entity after the acquisition.

An entity qualifies as an affiliated entity if the Dutch taxpayer has or acquires a direct or indirect interest of at least one-third in the entity or vice versa, or if a mutual (indirect) shareholder has or acquires a direct or indirect interest of at least one-third in both the Dutch taxpayer and the other entity.



The interest expenses should not be allowed if the taxpayer is able to demonstrate that:

- (a) the debt and the related transaction are predominantly business-driven; or
- (b) the interest payments are effectively taxed in the hands of the creditor at a tax rate of 10% on a taxable profit calculated in accordance with Dutch tax law and the recipient is not eligible to offset tax losses or other claims against the interest income.

However, if the Dutch tax authorities can reasonably establish that:

- (a) the debt is provided with the intention to set off tax losses or use other claims arising in a current year or the near future; or
- (b) the debt or the relating transaction is not predominantly business-driven,

then the interest expenses are not deductible.

Interest deduction limitation in relation to hybrid loans

Interest expenses incurred on a loan that is reclassified as equity for tax purposes (**Hybrid Loan**) are not deductible for Dutch tax purposes. A loan is reclassified as equity for tax purposes if:

- (a) the remuneration on the loan depends (almost) entirely on the profit of the debtor;
- (b) the loan is subordinated to all creditors; and
- (c) the loan:
 - (i) does not have a fixed term but may be reclaimed only upon bankruptcy, insolvency or liquidation of the debtor; or
 - (ii) has a term of more than 50 years.

Interest deduction limitation on basis of the arm's length principle

All transactions between related entities should be entered into on an arm's length basis. For example, the conditions (e.g., interest rate, term, principal amount) on a loan between related parties should be at arm's length. If, certain conditions of a transaction are not at arm's length, the Dutch tax authorities could adjust the reported figures in a tax return. The interest expenses in excess of the arm's length interest expenses may not be tax-deductible nor qualify as deemed dividend distributions

Interest deduction limitation in relation to certain group loans

Interest expenses are not deductible for Dutch corporate income tax purposes if:

- (a) a related entity has provided the loan;
- (b) that loan does not have a fixed maturity date or has a maturity of more than 10 years; and
- (c) the remuneration on the loan is significantly (more than 30%) lower than the market rate.

Interest deduction limitation for acquisition holdings

In the past, if a Dutch acquisition vehicle acquired a Dutch target company using (group) debt, then the interest expenses of the acquisition vehicle could under normal circumstances be offset from the profits of the target company by forming a Dutch fiscal unity or by (de)merging the companies.

From 1 January 2012, the deduction of interest expenses at the level of the acquisition vehicle with profits of the target company have been disallowed to the extent the debt used by the acquisition company to acquire the target exceeds 60% of the acquisition price of the target company. The percentage of 60% is reduced to 55% in the second



year, 50% in the third year, and so on, until it reaches 25% of the acquisition price. Notwithstanding this ratio, there is an annual allowance for the first EUR 1,000,000 of interest expenses. The excessive interest expenses will only be deductible from the acquisition holding's own taxable profit and not from the target company's taxable profit.

Interest deduction limitation in relation to excessive Participation Debt

This (new) rule limits the deductibility of excessive interest expenses and costs related to debt that is used for the acquisition of shares in, or capital contribution to the share capital of, subsidiaries that qualify for the Dutch participation exemption. Acquisitions of, or capital contributions to, a subsidiary that relate to an expansion of operational activities of the group, to which the taxpayer belongs, are not targeted by the new rule. Furthermore, the rule contains an annual allowance for the first EUR 750,000 of excessive interest expenses.

The rule only applies to the extent that the annual average fiscal cost price of the subsidiaries exceeds the annual average fiscal equity. This excessive part is deemed to be financed out of debt (**Participation Debt**). The Participation Debt is reduced by debts the interest expenses of which are not deductible under other provisions of Dutch fiscal law. To calculate the potential limitation of the deduction of interest and costs related to the total debts, one must first divide the Participation Debt by the total annual average loan payable. The outcome must in turn be multiplied by the total interest expense and costs. The total annual average outstanding loans include both related party debt and third party debt and exclude outstanding loans of which the interest expenses are not deductible under other provisions of Dutch fiscal law.

Acquisitions, expansions of, or capital contributions to, subsidiaries that relate to an expansion of the operational activities of the group are not targeted by the rule, if the expansion of the activities commences

within 12 months from the acquisition, expansion or capital contribution. This exception is, however, not applicable if:

- (a) the debt financing of the acquisition or contribution is structured in such a way that interest expenses can be also deducted in another country (double dipping);
- (b) the debt financing is used by the Dutch taxpayer to grant a Hybrid Loan the interest expense of which is deductible abroad and not taxed in the hands of the Dutch taxpayer, and the interest expense due by the Dutch taxpayer is not subject to reasonable taxation in the hands of the lender; or
- (c) it is likely that the transaction would not have been executed by the Dutch taxpayer if no interest could have been deducted in the Netherlands

Interest deduction limitation on the basis of thin capitalization rules

From 1 January 2013, Dutch tax law no longer contains thin capitalization rules. The reason for abolishing the thin capitalization rules is mainly that the Dutch legislator has introduced specific (antiabuse) provisions which limit the deduction of interest expenses. Therefore, in the view of the Dutch legislator, a general interest deduction limitation rule is no longer required.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in the Netherlands?

The trustee in bankruptcy is not required to accept contractual subordination. The trustee is authorized to default on all contractual obligations and cannot be forced to fulfill any of the debtor's obligations vis-à-vis its creditors. Therefore, the trustee may choose to default on a contractual subordination although in practice this is rarely done.



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Peru

 Is there any prohibition on a company incorporated in Peru providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Peruvian law generally prohibits a company from providing financial assistance in connection with the acquisition of its own shares. In particular, Article 106 of the Peruvian Corporations Law (Corporations Law) prohibits a company from:

- (a) granting loans, providing collateral or a guarantee for the acquisition of its own shares; or
- (b) providing or receiving collateral where that collateral consists of the company's own shares.

These prohibitions, however, do not extend to the shares of that company's parent company (either direct or ultimate).

2. What are the implications under the corporate benefit laws of Peru for a company providing financial assistance?

Article 106 of the Corporations Law provides that a company's board members are liable for decisions that are considered financial assistance under Peruvian law.

Peruvian law requires that all corporate actions must benefit a company. Peruvian law also requires directors to act with the diligence of an orderly business person and loyal representative of the company. In particular, Article 177 of the Corporations Law provides that directors are jointly liable for damages and losses caused to the company, shareholders and third parties, through their actions when performed against the law or bylaws of the company or otherwise involve willful misconduct, abuse of authority or gross negligence.



In the case of financial assistance, the facts and circumstances of each transaction must be thoroughly analyzed to ensure that board members will not become liable.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most common types of security interests in Peru are mortgages (hipotecas) over real estate, security interests (garantía mobiliaria) over movable assets, and trusts (*fideicomisos*) in relation to all kinds of assets

Even though mortgages and security interests are the most common types of collateral used by parties, trusts generally provide creditors with protection against a debtor's bankruptcy.

Mortgages are required to be created through public deeds before a notary public to be enforceable and are perfected by registration with the Public Registry. Security interests and trusts may be created through agreements but are customarily formalized through public deeds. In the case of security interests and trusts, perfection depends on the type of asset but, in most cases, perfection requires registration with the relevant Public Registry.

No taxes are generally applicable in relation to the granting of security interests

The following table provides a basic description and estimated costs of the most common types of security used in Peru:

Description of Security Interest

Mortgages (*Hipotecas*)

A mortgage is a security granted over real estate assets, by which the owner creates a lien to guarantee the performance of an obligation and the asset remains the property of the owner. The mortgage must be granted by the owner of the asset by means of a public deed before a notary public, and is perfected by registration with the Public Registry. If there is a default, the secured creditor cannot directly enforce the mortgage but must follow a judicial proceeding in order to sell the assets at a public auction.

Comment

Cost

i. Registration fees:

Based on the value of the secured obligation, subject to a cap of one tax unit.³⁴

ii. Notary fees:

Based on a fee schedule but can be negotiated.

Trusts (Fideicomisos)

Under this type of security interest, the owner of assets to be delivered as collateral transfers them to a trustee (a regulated entity authorized to act as trustee) who manages and holds the collateral as trustee for the benefit of the beneficiaries of the trust. If a default occurs, the trustee may, under the terms and conditions of the trust agreement, sell or dispose of the assets without judicial proceedings, or otherwise deliver the assets to creditors as paymentin-kind. This type of guarantee is generally more flexible in terms of documentation and stipulations than the mortgage or security interests, but it may be more expensive as it will need to include the fees of the trustee.

Costs

i. Trust fee:

As negotiated.

ii. Registration Fee:

If applicable, based on the value of the secured obligation, subject to a cap of one tax unit.

iii. Notary Fees:

Based on a fee schedule but can be negotiated.

³⁴ For 2015, the tax unit is equivalent to PEN3,850.

Based on a fee schedule

but can be negotiated.



Description of Security Interest		Comment	
	Security interest over movable assets (garantía mobiliaria)	Co i.	st Registration Fees:
	A security interest (<i>garantia mobiliaria</i>) is a security interest established over personal property (either tangible or intangible). In contrast to mortgages, if there is a default, a secured party, acting through an enforcement agent, may sell or dispose of	ii.	If applicable, based on the value of the secured obligation, subject to a cap of one tax unit. Notary fees:

the assets without judicial proceedings, or

otherwise deliver the assets to the secured

creditors as payment-in-kind.

4. How long, following acquisition of a foreign target company, would it usually take in Peru for a Peruvian subsidiary of the foreign target company to grant a guarantee/ security?

Following the acquisition, the restrictions described in the answer to question 1 continue to apply.

5. Are there any restrictions on foreign banks lending to companies in Peru? Are interest payments to foreign banks typically subject to withholding tax?

There are no restrictions on foreign banks lending to Peruvian companies.

Interest payments made by a Peruvian company to a foreign company in connection with a loan are subject to a 4.99% withholding income tax rate, if:

- (a) the proceeds from the loan are used in Peru;
- (b) the interest rate does not exceed LIBOR plus seven basis points; and

(c) the foreign lender is not an affiliate of the borrower and is not located in a "tax haven" or a jurisdiction otherwise considered to have low taxes.

If conditions (a) or (c) above are not met, the applicable withholding income tax rate is 30%.

If conditions (a) and (c) are met but the interest rate exceeds LIBOR plus seven basis points, the applicable withholding tax rate will be 30% on the amount relating to the excess of LIBOR plus seven basis points.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Peru, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

The Peruvian securities market law and the tender offer regulations require any person that directly or indirectly acquires, in one or a series of transactions, a "substantial interest" in a company that has at least a class of shares with voting rights registered with the *Superintendencia del Mercado de Valores*, to launch a tender offer (oferta pública de adquisición).

A person who directly or indirectly intends to acquire, in one or a series of transactions, a "substantial interest" is also required to launch a tender offer before acquiring the "substantial interest" unless that person acquires the substantial interest:

- (a) indirectly;
- (b) in a public secondary offering of securities;
- (c) in a single transaction; or
- (d) in no more than a series of four consecutive transactions in a period of three years.



A "substantial interest" in a company is acquired when a person acquires or intends to acquire a number of common shares that:

- (a) will result in that person beneficially (directly or indirectly) owning 25%, 50% or 60% of the outstanding shares with voting rights of a company in one or a series of transactions; or
- (b) allows that person to:
 - (i) appoint a majority of the directors of a company; or
 - (ii) amend the bylaws of a company.

Peruvian tender offer regulations require that tender offers be irrevocable and guaranteed in cash, by a financial institution, or by another type of approved unconditional guarantee. Accordingly, Peruvian regulations do not allow for a tender offer to be conditional on obtaining financing.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

If a corporation (other than financial institutions that are subject to specific regulations) becomes insolvent or is otherwise liquidated, all payment obligations would be made in accordance with the terms of a liquidation plan approved by the creditors' committee and priority of payment would be granted in the following descending order established by the Bankruptcy Law (*Ley General del Sistema Concursal*) (**Bankruptcy Law**):

- (a) all debts owing to employees (e.g., workers' salaries and social benefits);
- (b) all secured debt;
- (c) all tax related indebtedness and obligations; and

(d) all unsecured debt.

Peruvian law provides that equity holders are able to collect on their equity claims only after all the above-listed groups of creditors have been paid in full.

8. Is interest on debt incurred to acquire a company in Peru deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Interest payments on debt used to fund an acquisition are generally tax deductible in Peru, if the loan is related to taxable activities. However, under Peru's thin capitalization rules, where the lender and the borrower are affiliates, interest payments in excess of those derived from a loan the outstanding principal amount of which exceeds three times a company's net worth as of the end of the most recent fiscal year, are not deductible for Peruvian income tax purposes.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Peru?

If a bankruptcy procedure (*concurso*) is initiated, the creditors of a company under that procedure, acting through a general creditors' meeting, will be required to choose between restructuring or liquidating the company. Decisions of the general creditors' meeting are made by the relevant majority (as the Bankruptcy Law sets out different majority approval thresholds for different types of decisions) and each creditor will have as many votes in the meeting as the percentage of the total debts of the company that the debts owed to it represents.

If the general creditors' meeting opts for the liquidation of the company, the liquidator is required to pay the company's debts in the order of priority set out in the Bankruptcy Law as stated in the answer to question 7.



Contractual subordination should be honored by the liquidator. If the general creditors' meeting chooses to restructure the company, there is a risk, however, that in some instances contractual subordination might not be honored and payments may be made in accordance with the restructuring plan approved by the general creditors' meeting.

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Philippines

1. Is there any prohibition on a company incorporated in the Philippines providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

There is no statutory restriction in the Philippines on a corporation providing financial assistance³⁵ in connection with the acquisition of its own shares or those of its parent corporation.

A corporation can exercise powers that are:

- (a) expressly allowed under the Corporation Code of the Philippines (Corporation Code);
- (b) authorized in the purpose clause of its articles of incorporation (**AOI**); and
- (c) incidental to its existence, or implied or necessary to carry out the purposes as stated in its AOI.

Therefore, unless the AOI contains an express restriction from doing so, a Philippine corporation may provide financial assistance in connection with the acquisition of shares in itself or its parent corporation, if:

(a) the giving of the financial assistance is reasonably justified to be furthering the Philippine corporation's primary purpose(s); and

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³⁵ "Financial assistance" for the purposes of this review means financial assistance in connection with an acquisition given by a company which has been acquired or whose parent company has been acquired by way of:

⁽a) guarantee or indemnity in respect of the obligations of the acquirer;

⁽b) grant of security to support the obligations of the acquirer;

⁽c) loans or transfer of assets to the acquirer; or

⁽d) dividend or other distribution to the acquirer following the acquisition.



(b) the applicable approvals are obtained.

Incur, create or increase bonded indebtedness

Under the Corporation Code, no corporation may incur, create or increase any bonded indebtedness unless approved by a majority vote of the board of directors and by the stockholders representing at least two-thirds of the outstanding capital stock. The Philippine Securities and Exchange Commission (SEC) has ruled that the term "bonded indebtedness" refers to bonds that are secured by corporate property, as distinguished from "debentures," which are unsecured corporate indebtedness.

Sell, dispose of, lease or encumber assets

Under the Corporation Code, a corporation, when authorized by a majority vote of the board of directors and by the stockholders representing at least two-thirds of the outstanding capital stock, may sell, lease, exchange, mortgage, pledge or otherwise dispose of all or substantially all of its property or assets. The test for determining whether the transaction involves "substantially all" of the corporate assets or property is whether the sale or disposition of the relevant corporate property or assets will render the corporation incapable of accomplishing its corporate purposes.

Apart from the requirements under the Corporation Code, the mortgage, sale or disposition of all or substantially all of the corporate assets or property may require compliance with the Philippine Bulk Sales Law (**Bulk Sales Law**). If the transaction qualifies as a "sale-in-bulk" under the Bulk Sales Law, the seller is required:

- (a) to execute a sworn statement listing its corporate creditors, or those with claims (whether already due or not) that are existing prior to the sale, mortgage or disposition of corporate assets or property, and the amount and nature of their claims;
- (b) to give notice of the sale; and

(c) to apply the proceeds of the sale proportionately to the payment of the listed obligations.

Compliance with the Bulk Sales Law may be waived in writing by corporate creditors.

Corporate funds in another corporation or business

Under the Corporation Code, a corporation may invest its funds in another corporation or business or for any other purpose other than the primary purpose as stated in its AOI when approved by a majority of the board of directors and ratified by the stockholders representing at least two-thirds of the outstanding capital stock.

Guarantee

So that a Philippine company may guarantee the performance of the obligations of another firm, entity or person, the AOI of that Philippine corporation should expressly include, as one of its secondary purposes, that it is authorized to guarantee the performance of any undertaking or obligation of other firms, entities or persons.

Third party mortgage or pledge

The SEC has ruled that if a corporation wishes to authorize the mortgage or pledge of its corporate assets as security for the obligations of another firm, entity or person, it must comply with the following conditions:

- (a) there is no express restriction in the AOI or bylaws;
- (b) the purpose of the mortgage or pledge is not illegal;
- (c) written or formal consent of corporate creditors and stockholders must be secured;
- (d) the transaction is not used as a scheme to defraud or prejudice creditors or result in the infringement of the trust fund doctrine; and



(e) the mortgage will not hamper the continuous business operations of the mortgagor corporation, and the accommodated third party involved is financially solvent and capable of paying the creditor.

Dividends

A corporation can only distribute dividends to stockholders. The board of directors of a Philippine stock corporation can declare dividends out of unrestricted retained earnings, which may be payable in cash, property or stock. A corporation may not issue dividends in the form of stock without the approval of stockholders representing at least two-thirds of the outstanding capital stock.

2. What are the implications under the corporate benefit laws of the Philippines for a company providing financial assistance?

Directors' duty of diligence

The Philippine Supreme Court has held that the primary obligation of the directors of a corporation is "to seek the maximum amount of profits for the corporation," and characterized a director's position as a "position of trust." This fiduciary relationship is not a matter of statutory law, but springs from the fact that directors have control and guidance of corporate affairs and property and therefore of the property interest of the stockholders.

In line with the directors' fiduciary duty, the Corporation Code provides that directors who willfully and knowingly vote for or assent to patently unlawful acts of the corporation or who are guilty of gross negligence or bad faith in directing the affairs of the corporation are liable solidarily (jointly and severally) for all damages suffered by the corporation, its stockholders and other persons as a result of those acts by those directors. At risk of being made personally liable for damages suffered by the corporation, its stockholders and other persons, directors are mandated by this provision to observe a duty of diligence in connection with the corporation providing financial assistance

Corporate rehabilitation scenario

Under the Financial Rehabilitation and Insolvency Act of 2010 (FRIA), "corporate rehabilitation" is defined to refer to the restoration of the corporate debtor to a condition of successful operation and solvency, if it is shown that its continuance of operation is economically feasible and its creditors can recover more by way of the present value of payments projected in the rehabilitation plan if the debtor continues as a going concern than if it is immediately liquidated.

If the Philippine corporation providing the financial assistance becomes the subject of corporate rehabilitation, the corporate benefit received by the Philippine corporation in connection with providing the financial assistance may have an impact on the rehabilitation court's determination of the terms of repayment or enforcement of obligations incurred by the Philippine corporation in connection with providing the financial assistance.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

In general, a security interest can be taken on all kinds of movable and immovable property, whether tangible or intangible. In the Philippines, the most widely recognized forms of security arrangements over shares and assets are pledges and mortgages.

Pledge

Delivery of the pledged property into the actual possession of the creditor or other person by common agreement is essential to perfect a pledge. To be valid against third persons, a description of the property pledged and the date of the pledge must appear in a public instrument.



A document is considered a public instrument when it is notarized, or signed and executed before a notary public.

The pledge instrument need not be registered. However, if the creditor/pledgee is given the right to attend and vote at the meetings of stockholders of the corporation whose shares are subject to a pledge. that right must be in writing and recorded in the corporate books (i.e., stock and transfer book) of the relevant corporation.

Mortgage

In creating a mortgage, there is a need to determine whether the property the subject of the mortgage is, on the one hand, immovable or real property or, on the other hand, movable or personal property. If the property is real or immovable, the mortgage should be a real estate mortgage. If, however, the property is movable or personal, then the mortgage should be a chattel mortgage.

A mortgage instrument must be in writing, contain a specific description of the mortgaged property and be executed in the presence of at least two witnesses. In a chattel mortgage, an Affidavit of Good Faith must be executed by the parties and attached to, and registered with, the chattel mortgage instrument. The mortgage instrument is required to appear in a public instrument (i.e. be notarized, or signed and executed before a notary public) for it to be recorded in the proper Chattel Mortgage Register of the Registry of Deeds.

To bind third persons, the mortgage instrument must be registered with the proper Register of Deeds. In relation to real property, the mortgage must be recorded in the Registry of Deeds of the province or city where the property is located. On the other hand, a chattel mortgage must be registered in the Registries of Deeds in:

- (a) the province or city in which the mortgagor resides at the time of execution of the deed of chattel mortgage; and
- (b) (if different, also in) the province or city in which the property the subject of the mortgage is located.

In addition to the registration with the Register of Deeds, a mortgage over motor vehicles, vessels and airplanes must be registered with the Land Transportation Office and Maritime Industry Authority and Air Transportation Office, respectively.

If a mortgage is not recorded with the Register of Deeds, it is nevertheless binding on the contracting parties.

Documentary Stamp Tax

A Documentary Stamp Tax (**DST**) is imposed on pledges or mortgages based on the secured amount at the following rates:

- (a) when the amount secured does not exceed PHP5,000,³⁶ a DST of PHP20³⁷; or
- (b) on each PHP5,000,³⁸ or a fractional part thereof in excess of PHP5,000,³⁹ an additional tax of PHP10.

The DST return must be filed and the relevant tax paid to the Bureau of Internal Revenue within five days after the close of the month when the taxable document was made, signed, issued, accepted or transferred.

³⁷ Equivalent to approximately USD0.445 based on the BSP reference exchange rate of USD1=PHP 44.98 as of 16 January 2014.

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³⁶ Equivalent to approximately USD111.16 based on the BSP reference exchange rate of USD1=PHP 44.98 as of 16 January 2014.

³⁸ Equivalent to approximately USD111.16 based on the BSP reference exchange rate of USD1=PHP 44.98 as of 16 January 2014.

³⁹ Equivalent to approximately USD111.16 based on the BSP reference exchange rate of USD1=PHP 44.98 as of 16 January 2014.



4. How long, following acquisition of a foreign target company, would it usually take in the Philippines for a Philippine subsidiary of that foreign target company to grant a guarantee/security?

There are no statutory waiting periods for a Philippine subsidiary to issue a guarantee or establish a security constituting financial assistance. Timing will depend on when:

- (a) the approvals for issue of a guarantee or establishment of a pledge or mortgage are obtained;
- (b) the DST is paid, in the case of a pledge or mortgage; and
- (c) (in the case of a mortgage) the mortgage instrument is registered with the proper Registers of Deeds.
- 5. Are there any restrictions on foreign banks lending to companies in the Philippines? Are interest payments to foreign banks typically subject to withholding tax?

Doing banking business

A foreign bank lending in the Philippines may be subject to various regulatory and licensing requirements if it is:

- (a) doing banking business in the Philippines; or
- (b) engaged in the business of a financing corporation in the Philippines.

In these cases, a foreign bank will have to establish a presence in the Philippines and obtain the relevant permits and licenses. That Philippine entity may also be subject to foreign equity restrictions.

Under the Philippine General Banking Law, a foreign bank that engages in "banking business" must obtain:

- (a) a license to do business from the SEC; and
- (b) a certificate of authority from the Bangko Sentral ng Pilipinas (the Philippine Central Bank) (**BSP**).

Certificates of authority

The BSP issues different types of certificates of authority (e.g., to operate a universal, commercial, thrift, rural or co-operative bank). The requirements for obtaining a certificate of authority will depend on the type of authority being applied for. The activities that may be conducted by the grantee of the certificate of authority will also depend on the type of authority issued.

Investment in existing domestic banks

A foreign bank may operate as a bank in the Philippines, subject to the prior approval of the Monetary Board of the BSP, by owning up to 60% of the voting stock of an existing domestic bank. At present, the BSP has imposed an indefinite moratorium on the establishment of new banks, except in cities and municipalities where there are no existing banking offices. Therefore, a foreign bank cannot invest in the voting stock of a new banking subsidiary. If the moratorium is lifted, a foreign bank may also operate in the Philippines, subject to prior approval of the Monetary Board of the BSP, by investing in up to 60% of the voting stock of a new banking subsidiary incorporated under the laws of the Philippines.

Offshore banking units

A foreign bank may also obtain a certificate of authority to operate an offshore banking unit (**OBU**) or a representative office (**Rep Office**). An OBU does not have full banking authority and refers to a branch, subsidiary or affiliate of a foreign bank that is authorized to engage in banking transactions in foreign currencies involving the receipt of



funds principally from external sources and the utilization of those funds, as allowed by the BSP.

Representative offices

A Rep Office refers to a liaison office of a foreign bank that deals directly with the public by promoting and giving information about the services or products offered by the foreign bank. It is not allowed to transact banking business (such as acceptance of deposits, issuance of letters of credit and foreign exchange trading) or otherwise generate income. Transactions generated through the promotional efforts of the Rep Office may be booked only by the foreign bank abroad.

Syndicated loans

A foreign bank that participates in syndicated loans is not automatically considered to be doing business in the Philippines. Therefore, in cases where the foreign bank is not considered to be doing business, it need not obtain a license to do business from the SEC nor a certificate of authority from the BSP. There is, however, no hard and fast rule in relation to when a foreign bank may be considered to be doing business in the Philippines when it participates in syndicated loans. Therefore, it is common for foreign banks to obtain the SEC's opinion and, in appropriate circumstances, a BSP opinion on the proposed activity.

The SEC has on occasion ruled that mere participation in a syndicated loan, where only the execution of the loan documents is done in the Philippines, an act that is considered by the SEC as merely preparatory to the loan agreement, is not considered "doing business" in the Philippines, particularly when the loan and the delivery of funds occurs abroad. ⁴⁰

⁴⁰ SEC Opinion addressed to Senior Deputy Governor Singson dated 9 February 1982; SEC Opinion addressed to Governor Singson dated 7 October 1981.

Conversely, where funds from the loan will be delivered in the Philippines and the loan agreement is actually consummated in the Philippines, the foreign bank may already be considered to be doing business in the Philippines. ⁴¹ However, if participation in a syndicated loan is an isolated transaction, ⁴² i.e., the foreign bank participates in only a single or occasional loan agreement without intention to engage in the progressive pursuit of business, the foreign bank may not be considered to be doing business in the Philippines. If those circumstances applied to a foreign bank, it would be prudent to have the position confirmed by a legal opinion from the SEC.

Engaging in a financing company business

A foreign bank which engages in a "financing company business" as defined under the Financing Company Act of the Philippines (FCA) must establish a Philippine stock corporation, which must be at least 40% Filipino-owned, and obtain authorization from the SEC to operate as a financing company.

A financing company, in the context of the FCA, is an entity primarily engaged in extending credit facilities directly to consumers and to industrial, commercial or agricultural enterprises located in the Philippines on a continuing basis by:

(a) direct lending, discounting of commercial papers or receivables;

⁴¹ Under Republic Act 7042 as amended by Republic Act 8179 (**Foreign Investments Act**), "doing business" includes "any other act or acts that imply a continuity of commercial dealings or arrangements, and contemplate to that extent the performance of acts or works, or the exercise of some of the functions normally incident to, and in progressive prosecution of, commercial gain or of the purpose and object of the business organization."

This is an exception to the "doing business" rule under the Foreign Investments Act. Application of this exception is found in SEC Opinion No. 34-04 addressed to Toyo-Obayashi-Ube-Joint Venture dated 8 June 2004; MR Holdings v. Bajar, GR No. 138104, 11 April 2002; Eriks Pte. Ltd v. Court of Appeals, et. al., GR No. 118843, 6 February 1997.



- (b) buying and selling contracts, leases, chattel mortgages, or other evidence of indebtedness; or
- (c) financial leasing of movable as well as immovable property.

If that entity will engage in quasi-banking functions, it must also obtain the appropriate authorization from the BSP. Quasi-banking is defined as borrowing funds for the purpose of relending or purchasing receivables from 20 or more lenders at any one time, by issue, endorsement or acceptance of debt instruments other than deposits.

Interest payments

Interest payments to foreign banks are typically subject to withholding tax.

Under the Philippine tax law, non-resident foreign corporations not engaged in trade or business in the Philippines are generally subject to a 20% final withholding tax on gross interest received on loans granted to Philippine residents. The 20% final withholding tax rate may be reduced under provisions of Philippine tax treaties with the country where the non-resident foreign corporation is domiciled.

If the foreign bank derives interest income from foreign currency loans granted to Philippine residents:

- (a) through an OBU authorized by the BSP; or
- (b) under the expanded foreign currency deposit system (EFCDU),

the interest income will be subject to 10% final withholding tax.

In this context, the term "Philippine residents" excludes other offshore banking units, local commercial banks (including local branches of foreign banks that may be authorized by the BSP to transact with OBUs), and other depository banks under the EFCDU system.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in the Philippines, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Under the Philippines Securities Regulation Code (**SRC**), a tender offer ⁴³ is defined as an offer by an acquiring person to the stockholders of a public corporation ⁴⁴ for them to tender their shares on the terms specified in the offer. The share acquisition will be subject to the rules on "mandatory tender offer" under the SRC if the number of shares intended to be acquired will reach the trigger threshold of generally 35% or more of a class of equity securities or shares of stock.

Rule 19 of the implementing rules of the SRC requires any person making a tender offer to make an announcement of his/her intention in a newspaper of general circulation prior to the commencement of the offer. The announcement must not be made until the bidder has the resources to implement the offer in full. The SEC also requires the filing by the bidder of, among other things, confirmation by the bidder's financial adviser or another appropriate third party that resources available to the bidder are sufficient to satisfy full acceptance of the offer.

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⁴³ A tender offer is a publicly announced intention by a person, acting alone or in concert with other persons, to acquire equity securities of a public company.

⁴⁴ A public company is defined as a corporation (a) which is listed on the Philippine Stock Exchange (**PSE**), or (b) with assets exceeding PHP50,000,000 or USD1,111,605.16 based on the BSP reference exchange rate of USD1=PHP 44.98 as of 16 January 2014, and with 200 or more stockholders, at least 200 of whom hold not less than 100 shares of such company.



7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Order of priority

Under the FRIA, the obligations of an insolvent debtor will be paid following the order of priority established in the Civil Code of the Philippines (**Civil Code**) and other relevant laws dealing with the concurrence and preference of credits, unless a preferred creditor voluntarily waives his/her preferred right. The order of priority is set out below

Special preferred credits

There are special preferred credits with respect to specific movable property under Article 2241⁴⁵ of the Civil Code and special preferred credits with respect to specific real property under Article 2242⁴⁶ of the Civil Code.

things pledged or mortgaged, up to the value thereof; and

possessor within 30 days from the unlawful seizure.

46 Article 2242 of the Civil Code provides that, with reference to specific immovable property and real rights of the debtor, certain claims, mortgages and liens shall be preferred, and shall constitute an encumbrance on the immovable or real right:

(b) For the unpaid price of real property sold, upon the immovable sold;

⁴⁵ Article 2241 of the Civil Code provides that, with reference to specific movable property of the debtor, certain claims or liens shall be preferred including:

⁽a) duties, taxes and fees due thereon to the State or any subdivision thereof; (b) credits guaranteed with a pledge so long as the things pledged are in the hands of the creditor, or those guaranteed by a chattel mortgage, upon the

⁽c) claims for laborers' wages on the goods manufactured or the work done; In preferred cases, if the movables to which the lien or preference attaches have been wrongfully taken, the creditor may demand them from any

⁽a) Taxes due upon the land or building;

There is a first-tier preference that includes only taxes, duties and fees due on specific movable or immovable property. All other special preferred but non-tax credits (e.g., credit secured by mortgages) stand on the second tier to be satisfied *pari passu* out of any residual value of the specific property to which the other credits relate. This rule, however, does not apply to credits registered with the Register of Deeds, by virtue of a judicial order, by attachment or execution. In satisfying these credits, the rule is priority of the credits in the order of time

Ordinary preferred credits

Ordinary preferred credits are listed under Article 2244⁴⁷ of the Civil Code. Credits that do not enjoy any preference with respect to specific property because they are not among those listed under Articles 2241 and 2242 and those that, while included in these Articles, are unpaid because the value of the property to which the preference refers is less than the preferred credit(s), will be satisfied in the order established in Article 2244. For the purposes of implementing the liquidation plan under the FRIA, credits for services rendered by employees or laborers to the debtor will enjoy first preference under Article 2244 of the Civil Code, unless the claims constitute legal liens under Articles 2241 and 2242. Unlike Articles 2241 and 2242, Article 2244 creates no liens on determinate property of the debtor. Article 2244 creates

⁽c) Claims of workmen engaged in the construction, reconstruction or repair of the immovable property;

⁽d) Mortgage credits recorded in the Registry of Property, upon the real estate mortgaged; and

⁽e) Credits annotated in the Registry of Property, by virtue of a judicial order, by attachment or execution, upon the property affected, and only as to later credits.

⁴⁷ Article 2244 of the Civil Code provides that with reference to other property of the debtor to which no specific liens attach, certain unsecured claims or credits shall receive preferential treatment, including employee claims, advances made in the preceding 12 months, funding in insolvency and unsecured tax claims.



preference in favor of certain creditors to have the assets of the insolvent debtor applied in a certain sequence or order of priority.

Ordinary claims

Ordinary claims are claims that are not included in the order of priority stated above, and have been duly proved and approved in the liquidation proceedings.

Ordinary claims will share pro rata in the remainder of the debtor's property, without any priority or preference.

Under the FRIA, the rehabilitation plan must provide for equal treatment of all claims within the same class or sub-class of creditors, unless a particular creditor agrees to less favorable treatment.

Trust fund doctrine

Philippine law adheres to the trust fund doctrine, which provides that the capital stock of the corporation, as well as its property and assets, are generally regarded in equity as a trust fund for the payment of corporate debts and the creditors have the right to priority payment over any stockholders of the corporation.

Consistent with the trust fund doctrine, debt holders are given preference over equity holders. On liquidation of the corporation, only the balance after paying the claims of corporate creditors is to be distributed to the stockholders

8. Is interest on debt incurred to acquire a company in the Philippines deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Interest on debt incurred is generally deductible from earnings for income tax purposes.

There are no statutory thin capitalization thresholds that are imposed generally. However, certain debt-to-equity ratios are required in

connection with registering with certain government agencies, such as the SEC with respect to an application for registration of a Philippine branch and the Board of Investments, or qualifying as proponents of certain government projects.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in the Philippines?

Financial Rehabilitation and Insolvency Act

The FRIA prescribes the order of priority in which the obligations of the debtor must be paid (after the debtor's assets are liquidated), as follows:

- (a) special preferred credits under Articles 2241 and 2242 of the Civil Code;
- (b) ordinary preferred credits under Article 2244 of the Civil Code, if for the purposes of implementing the liquidation plan under the FRIA, credits for services rendered by employees or laborers to the debtor will enjoy first preference; and
- (c) ordinary claims, which are claims approved and allowed in the liquidation proceedings and not falling in (a) or (b) above.

Based on the above order of priority, a Philippine court exercising jurisdiction over liquidation proceedings may refuse to recognize a contractual subordination that is not consistent with the order of priority prescribed under the FRIA.

Corporate rehabilitation

The provisions on corporate rehabilitation under the FRIA provide that contracts and other arrangements between the debtor and its creditors will be interpreted as continuing to apply to the extent that these contracts and other arrangements are not in conflict with the approved rehabilitation plan. The approved rehabilitation plan is binding on all persons who may be affected by it, including creditors



who may not have participated in the proceedings or those who oppose the approved rehabilitation plan. Therefore, any subordination agreement may be rendered ineffective, if:

- (a) that priority/subordination agreement is not recognized in the rehabilitation plan; or
- (b) even if it is recognized (e.g., over the objection of the subordinated lenders), the rehabilitation court subsequently determines that maintaining that preference will ultimately prevent or hinder the rehabilitation of the corporation.

Nevertheless, the FRIA recognizes an out-of-court or informal restructuring/workout agreement or rehabilitation plan (**OCRA**). An OCRA must comply with the requirements prescribed under the FRIA, such as approval by the debtor and by the required percentage per class of creditors (secured, unsecured and total), as well as publication of notice. Once approved by the court, an OCRA has the same legal effect as the confirmation of a rehabilitation plan under a court-supervised rehabilitation under the FRIA.

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Poland

 Is there any prohibition on a company incorporated in Poland providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

The term "financial assistance" under the Polish Commercial Companies Code (CCC) refers to all forms of financial support granted by a company to a third party to allow that third party to acquire shares in that company or the shares of its holding companies.

Financial assistance provided by a company may therefore include granting loans, issuing promissory notes, making advance payments and granting the relevant security (e.g., guarantees, pledges or mortgages) in favor of an entity acquiring underlying shares. However, the notion of financial assistance does not encompass payments that, by virtue of a corporate relationship, are made to shareholders. Therefore, payment of dividends or payment for redeemed shares is not considered to be financial assistance.

Under Polish law, financial assistance is only legally recognized in relation to a joint stock company (**PLC**). There are no equivalent regulations in relation to a limited liability company (**LLC**) or any other type of company. Therefore, provisions introducing certain rigorous conditions (as described below) to be met in order to validly grant financial assistance, apply only in relation to joint stock companies.

The acquisition of shares by a company incorporated in Poland is governed by the CCC, although as already indicated above, the rules relating to financial assistance diverge between those that apply in relation to a PLC on the one hand and other legal forms of Polish companies (including a LLC) on the other hand.



Under Article 345 of the CCC, there is a general rule that financial assistance is allowed in relation to a PLC, if certain conditions outlined in Article 345 § 2-5 of the CCC are met.

By Article 345 § 1 the CCC, a PLC is authorized to finance, directly or indirectly, the acquisition or/and subscription of its shares, in particular by granting loans, making advance payments or providing security. The above rule is limited by certain additional requirements, provided for in Article 345 § 2-5 the CCC. Under this Article, the acquisition or subscription must be made:

- (a) on market terms, in particular with regard to the interest received by the company or security created for the benefit of the company on account of the loans made or advances paid, as well as after the solvency of the debtor has been checked;
- (b) at a fair price;
- (c) further to an earlier creation of a reserve capital for that purpose, from the amount which may be allocated for division using the company's distributable reserves;
- (d) after a resolution of the shareholders' general meeting based on the written report issued by the management board setting out:
 - (i) the reasons for the financing;
 - (ii) the advantages the company will enjoy as a result of the financing;
 - (iii) the influence the financing may have on the financial condition of the company issuing the shares;
 - (iv) detailed financing conditions;
 - (v) the security to be established; and
 - (vi) the fair price.

In relation to the remaining (non-PLC) types of companies, the above requirements of the CCC do not apply. Those companies therefore may grant financial assistance generally without direct legal restrictions except for in relation to corporate benefit, which are discussed in the answer to question 2.

2. What are the implications under the corporate benefit laws of Poland for a company providing financial assistance?

Corporate benefit

As a matter of principle, a company established under Polish law must carry out its business for its own benefit and the actions it performs must be reasonably justifiable. A company is not required, however, to always receive consideration on market terms in relation to the arrangements that it enters into. Nevertheless, it must be possible for the company to show, at least in the long term, that it has received a benefit in relation to the acts it carries out.

Granting security

Therefore, if a Polish company grants security in relation to a facility agreement it would be advisable for it also to be a debtor/obligor under the facility agreement and the beneficiary of the financing made available under the facility agreement. This would create a legitimate reason for the Polish company to grant the security interest. Otherwise it is possible that the granting of the security by a Polish company may be deemed (by the company itself or its shareholders) to be detrimental to the company.

If a security granted by a Polish company is deemed (in a court proceeding) to be detrimental to the company, it could result in personal liability of the management board of the company for the damage caused in connection with the granting of the security interest.



Creditors

It is also important to note that the lack of corporate benefit may affect a company's external relationships. Acts of the company with no, or hardly any, benefit to the company may be criticized by the company's existing creditors for being carried out to the detriment of those creditors and therefore may be held to be ineffective in relation to those creditors. In those circumstances each creditor may demand that the court declares the relevant act to be ineffective in relation to him/her. It is, however, usually relatively difficult for the creditors to have this demand satisfied before the court due to evidentiary hurdles. If the relevant act of the company was carried out with no consideration, it would be easier for the creditors to prove that the act was performed to their detriment.

Disposal of assets

Moreover, acts carried out by the company, which bring no, or hardly any, benefit to the company have certain legal consequences in relation to the bankruptcy law as, under certain conditions, the relevant acts may be held to be ineffective against the bankruptcy estate once company has been declared bankrupt.

Therefore, any act by which the bankrupt company disposed of its assets (e.g., by encumbering them), carried out by the bankrupt within:

- (a) two months before the filing of the bankruptcy application will have no effect on the bankrupt estate if that act was performed in relation to the repayment or securing of a debt not actually due;
- (b) six months before the filing of the bankruptcy application will have no effect on the bankrupt estate if the act was carried out (even for consideration) by the bankrupt with his shareholder, dominant company or affiliated company, dominant company's or affiliated company' shareholders as well as their proxies;
- (c) one year before the filing of the bankruptcy application will have no effect on the bankrupt estate if that act was performed with no

consideration, or for consideration but the value of the bargain the bankrupt is obliged to perform is drastically in excess of the bargain received by the bankrupt.

If the acts of a Polish company can be shown to be reasonably justifiable and there is a legitimate benefit to the company in relation to those acts, the company's risk of court actions by creditors and transactions being set aside if it becomes bankrupt are minimized.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Under Polish law security interests are divided into the following groups:

- (a) security interests over property (*in rem*) i.e. special, privileged rights to defined elements of the property owned by the debtor or another party; and
- (b) "personal" security interests, i.e. the right to demand satisfaction of claims from a person other than the debtor or against the same debtor but on the basis of separate legal title (which is easier to enforce).

Security over shares and assets can be effected by the following types of security interests over property (*in rem*).

Mortgage

This security interest is a limited right over property that may be established generally over real property, perpetual usufruct right and receivables secured by a mortgage. Both the ownership title to, and possession of, the property remains with the debtor.



The mortgage is registered in the Land and Mortgage Register held by the court, and is available to the public. The mortgage comes into existence on registration by the court but with effect from the time of filing of the registration application with the relevant court. The mortgage gives the creditor a right of execution of his/her claim in relation to the mortgaged real estate irrespective of whose property it has become, and with priority over the personal creditors of the owner of the real estate. If more than one mortgage is established over particular real estate, the creditors secured by the mortgages are satisfied according to the priority ranking.

The application for registration is usually filed by the notary who prepared the notarial deed. Establishment of a mortgage may alternatively be perfected without notarial assistance by virtue of execution of banking mortgage documents. This option, however, is limited to mortgages established in favor of Polish banks. If mortgage documents are signed without notarial assistance the application for registration is usually filed by the mortgage debtor. The timing required for registration of the mortgage depends on the location of the court the application is filed with. In practice in the big cities the registration procedure usually takes longer because of the large number of applications dealt with and may last up to one year. In other locations it usually takes between two and six months. The relevant court competent for registration of the mortgage is the court in the district in which the real estate is located. A mortgage over real estate located in Poland must be governed by Polish law.

The notarial fees depend on the amount of the claim secured. They cannot, however exceed the amount of PLN 5,000 (EUR 1,250) per mortgage. The court registration fee of PLN 200 (EUR 50) must also be paid.

Registered pledge

This security interest is a limited right over property that may be established over existing and future movable property (except for sea ships entered into the sea ships register) and as well as existing and

future transferable rights (receivables (including receivables in bank accounts), intellectual property rights, shares etc.).

The registered pledge agreement needs to specify the maximum security amount up to which the secured receivable(s) may be satisfied out of the pledged asset(s). A registered pledge may be established by, and in favor of, any entity.

The ownership title to the pledged assets and possession may remain with the debtor. The debtor can generally freely dispose of, and use, the pledged assets (including amounts in bank accounts) within its daily business activities. A registered pledge allows a creditor to satisfy the debt from the pledged object prior to other creditors. A registered pledge is effective in relation to third parties, including purchasers of the movable property or encumbered rights.

A registered pledge is registered in a computerized and centralized Register of Pledges, held by the courts, and is available to the public. The pledge comes into existence on registration by the court. The applicable court fee amounts to PLN 200 (EUR 50) per pledge. The registration process usually takes from three weeks up to two months although longer and shorter registration periods have occasionally been observed. The application for registration can be filed by either the pledgor or the pledgee using the special application form a specimen of which is available on the internet.

A registered pledge encumbering assets located in Poland or a registered pledge encumbering shares in a company incorporated in Poland must be governed by Polish law.

Financial pledge

Financial pledge is also a limited right in relation to property but can only be established over cash or financial instruments (including shares) to secure pecuniary or other financial receivables.



Polish law limits the types of entities that are allowed to hold this type of collateral. Banks from the European Union are one of the types of entities that are allowed to be granted a financial pledge. It is important to note that one financial pledge over a particular single asset (e.g. bank account or shares) can secure one receivable only. The personal debtor does not have to also be the financial pledgor. Financial pledges are not subject to any registration requirements and are effective as soon as the relevant written agreement is final.

Civil law pledge

A civil law pledge is a limited right over property that may be established in relation to property and transferable rights such as receivables, intellectual property rights and shares. A civil law pledge right is effective against third parties, including purchasers of the encumbered property.

The ownership of the pledged assets (movable property and rights) remains with the debtor, but in the case of movable property possession must be transferred to a creditor or a third party appointed by the parties. A civil law pledge does not need to be registered. It provides the pledgee with weaker protection than a registered pledge. For example, a civil law pledge is not effective against *bona fide* subsequent pledgees or buyers of pledged assets, because Polish law allows a *bona fide* pledgee or purchaser to assume that a possessor of movable property has the ownership right in relation to that movable property. A civil law pledgee also enjoys less protection in execution proceedings, which means that claims secured with a civil law pledge have low priority, i.e. after tax or social security obligations.

Assignment of receivables

An assignment of receivables allows for the transfer of title to receivables and rights. Assignment is appropriate for all transferable rights and receivables. The assignment may be either conditional (on occurrence of an event of default defined by the parties) or effective immediately. Once the secured liabilities have been repaid in full the assignment expires and the assigned receivables are re-assigned.

A security assignment agreement should be made in writing. For the assignment to be effective under the Polish law on bankruptcy and reorganization, a certified date on the assignment agreement confirmed by a notary public is likely to be required.

It is advisable to notify each of the debtors of the Polish SPV (meaning a special purpose vehicle, a company which is directly involved in the realization of a project), including insurance companies that issued policies in favor of the Polish company, about the assignment and instruct them to pay any amounts due under the relevant agreements to the assignee. (A conditional assignment payment obligation, however, arises on the occurrence of an event of default). Otherwise each debtor, not aware of the assignment, may pay the due amounts to the assigner and satisfy the debtor's obligations to repay the debt but the assignee will not be paid. There is no requirement to register assignment agreements and there are no additional costs (except for the certification of the date – e.g., EUR 20) in relation to the assignment.

Transfer of ownership title by way of security

This security interest enables the transfer of title to assets. It is appropriate for movable property and rights (receivables). Possession of the assets used as security remains with the debtor. Transfer of ownership title is registered with public registries only in relation to assets for which there are specific registers such as automobiles and aircraft

Power of attorney in relation to the debtor's bank account

This security interest gives the creditor a right to access the cash in a debtor's bank account on the terms set out in the relevant power of attorney.



Subordination

Under Polish law there is a concept of contractual subordination of claims, in particular in relation to bank lending. This provides the bank with the contractual priority of its claims before the satisfaction by the borrower/guarantor of any other of its liabilities. Usually parties subordinate mezzanine debt and inter-company obligations.

Subordination, however, is not recognized in execution or bankruptcy proceedings and therefore is effective only between the parties to the subordination agreement.

To provide this security interest in favor of all security agents separate agreements with each of them would need to be entered into. There is no special form of the subordination agreement required and there are no additional costs in relation to subordination.

Surety

Any third party can act as a surety. The entity agreeing to be a surety to the creditor (**Surety Grantor**) undertakes to the creditor by entering into the surety agreement (**Surety Agreement**) to perform all duties of the debtor that the debtor does not perform on time. The scope of the Surety Grantor's obligation is determined by the scope of the debtor's obligations in each case.

If the debtor fails to perform its obligations, the creditor may demand payment from the Surety Grantor, even if the underlying agreement between the creditor and debtor is an effective document. The creditor must inform the Surety Grantor about the failure of the debtor to perform its obligations within the specified period of time. If the debtor fails to perform its obligations all of the assets of the Surety Grantor may be used to satisfy the obligations of the Surety Grantor, as the Surety Agreement may not be restricted to only some of the Surety Grantor's assets.

It should be pointed out that, unless otherwise specified, the Surety Grantor is liable as a joint and several co-debtor.

To provide this security interest in favor of all security agents separate agreements with each of them would need to be entered into. The Surety Agreement must be in writing. There are no additional costs in relation to entering into a Surety Agreement.

Voluntary submission to execution

Voluntary submission to execution is a statement in a form of a document allowing a creditor to accelerate the enforcement proceedings before the court. It does not itself create any separate security interest but instead facilitates the enforcement of a creditor's rights without the need for a creditor to prove its claims before the court.

To provide this kind of arrangement to all security agents a separate submission is required in relation to every receivable. If the lender is not a Polish bank the submission to execution is to be made in notarial form and its cost will not exceed PLN 10,000 (EUR 2,500).

4. How long, following acquisition of a foreign target company, would it usually take in Poland for a Polish subsidiary of that foreign target company to grant a quarantee/security?

There is no statutory waiting period for the granting of security by a Polish subsidiary of a foreign parent company. Therefore a Polish subsidiary may provide a guarantee/security immediately on completion of the acquisition. Certain security requires registration in a public register (i.e. mortgage and registered pledge) to be completely effective. Therefore there may be some delay in a security becoming completely effective because of a delay in relation to the relevant registrations.

Moreover a company must enter into transactions, including the granting of security interests, in accordance with its internal regulations as set out in its articles of association (or its statute/charter). This often requires obtaining prior written consent in



the form of a board or shareholders' resolution. Therefore, a Polish company should grant the relevant security interests after it obtains the corporate authorizations.

5. Are there any restrictions on foreign banks lending to companies in Poland? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

As a general rule, the provision of banking services, including loans to Polish entities from abroad, may be achieved by a bank with its registered office in a country within the European Union through so called cross-border operations without having to establish an institutional presence in Poland.

Cross-border operations are defined as activities "performed by a credit institution within the territory of Poland", if the operations are conducted without the participation of a branch of the credit institution. This definition means that the cross-border activities may be conducted in Poland only by a credit institution. A "credit institution" for the purposes of this definition is a bank having its registered office in the European Union and not a bank from outside the European Union.

This means that, in general, cross-border loans may be granted to Polish companies, without the need to set up a Polish branch, only by banks from countries within the European Union. The credit institution must also notify the Polish Financial Supervisory Authority on the cross-border operations to be conducted in Poland by that credit institution.

If however a foreign bank that is from outside the European Union is interested in granting loans to Polish companies, it must open a branch in Poland and offer its services on the Polish market via its Polish branch

Interest payments and withholding tax

Standard withholding tax on an interest payment abroad is 20%, but this may be lowered on the basis of tax treaties and in that case may range from 0% to 15%. Therefore, in each case the tax treaty applicable to the place of incorporation of the beneficiary of payments must be reviewed and the appropriate tax rate applied. For example, interest paid on loans of whatever kind granted by banks are exempt from withholding tax in Poland under several tax treaties e.g., with the United Kingdom, Germany, Belgium, the Netherlands or Austria. Furthermore, for evidentiary purposes, the foreign party will be required to deliver its certificate of residency, issued by the competent authorities in the place of its residence. Otherwise the Polish taxpayer will be obliged to withhold the tax based on the local 20% tax rate and pay it to the Polish tax office.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Poland, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Takeover bids in Poland are regulated by the Public Offerings Act 2005 (**Offerings Act**). Art. 74 stipulates that a takeover bid requires making an announcement of a tender and exchange offer for shares. The offer is made only after a security, whose value must be at least 100 % of the value of shares that are to be acquired, is offered and established. The establishment of security must be documented by a certificate of a bank or another financial institution that provides the security or intermediates in relation to providing the security.

In practice, a bank guarantee is usually provided when a takeover bid of a public company is made. It is also possible to set up a blocked bank account where funds for the required amount are held for the purposes of the takeover. A tender offer for shares in a public company should be made via an entity licensed to carry out brokerage activities in Poland. That entity must notify the target public company and the Polish Financial Authority about the tender offer.



7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

The order of priority on insolvent liquidation is covered by art. 342 of the act of February 28, 2003 - Bankruptcy and Rehabilitation Law (Journal of Laws from 2012 item 1112, as amended) (**Bankruptcy and Rehabilitation Act**). The Bankruptcy and Rehabilitation Act stipulates that debts owed by the bankruptcy estate are divided and satisfied according to five categories. Liabilities within each category are satisfied on a *pari passu* basis. Full satisfaction of liabilities falling into a particular category will cause the trustee to move to the next category until each creditor's claims are fulfilled or the proceeds resulting from the liquidation of the estate are exhausted, whichever happens first. The most important categories of liabilities falling under each category have been listed below.

Category 1

Category 1 covers liabilities such as:

- (a) costs of bankruptcy proceedings;
- (b) alimony and pension dues (if they have become payable after the bankruptcy date);
- (c) enrichment of the bankruptcy estate; and
- (d) other specific categories of receivables specified in the Bankruptcy and Rehabilitation Act.

Category 2

Category 2 covers debts such as:

- (a) receivables under employment contracts;
- (b) alimony and pension dues payable before the bankruptcy date; and

(c) social insurance pensions for the two years before the declaration of bankruptcy.

Category 3

Category 3 comprises:

- (a) taxes and other debts of a public character; and
- (b) other receivables owing to social insurance pensions including interest and execution costs.

Category 4

Category 4 covers all other receivables that are not specified under category 5, and specifically includes interest for the year before the bankruptcy date. Most liabilities incurred in the ordinary course of business are deemed to fall into this category.

Category 5

Category 5 is made up of interest, which does not fall into other categories, judicial and administrative penalties or fines and receivables in relation to donations and legacies.

If the bankrupt estate covers assets, over which limited property rights were once established, the proceeds from the sale of those assets will be distributed primarily to entities for the benefit of which those limited rights were established, except that deductions will be made to cover the costs of liquidation and any other costs of the bankruptcy proceedings to the maximum amount of one-tenth of the sum obtained from liquidation, but not more than the proportion of bankruptcy proceedings costs, which are attributable to the value of the asset being liquidated in relation to the costs incurred in relation to the whole bankruptcy estate. (art. 345 of the Bankruptcy and Rehabilitation Act). The remaining proceeds are distributed according to the five categories.



Under Polish law, debt holders are given certain priority over equity holders. Equity holders are regarded as residual claimants, and are entitled to proceeds, which although attributable to debt holders, have not been collected in due time as well as any other proceeds remaining after every creditor has been satisfied in full. Additionally, in relation to a company that is a PLC or an LLC, any loan granted to the company by the equity holder within two years before the insolvency will be treated as equity injected into the company by the shareholder.

8. Is interest on debt incurred to acquire a company in Poland deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Corporate income taxes in Poland are regulated by the Act of February 15, 1992 on legal persons' income tax (Journal of Laws from 2011 no 74 item 397, as amended) (**Legal Persons' Income Tax Act**). In general, as stated in article 15 item 1 of the Legal Persons' Income Tax Act any costs incurred for the purpose of generating the revenue earned or retaining or securing the source of revenue is deemed to be 'revenue earning costs'. Article 16 of the Legal Persons' Income Tax Act sets out a list of exemptions and specifically considers (art. 16 item 1 par. 8) expenses related to purchasing or obtaining securities or shares. The costs incurred to obtain or purchase those assets can only be recognized once they are sold or, if applicable, repurchased by the issuer. Therefore expenses such as notary fees, taxes on civil law transactions, or the price paid to subscribe or purchase shares can only be recognized at sale.

Other costs, such as interest on debt incurred are not necessary for the successful and effective purchase of the instruments described above, and therefore are deemed to be indirectly linked to the transaction. This means that the taxpayer may recognize interest on debt incurred as a revenue earning cost when incurred.

Interest is generally tax-deductible in Poland on a cash basis, i.e. when paid (or compounded to the principal amount of the loan). This interpretation seems to be shared by the Polish tax authorities. For

example, the Minister of Finance in an individual interpretation dated May 12, 2009 (IBPBI/2/423W-76/09 CzP) held that the use of 'expenditures on taking up or acquisition' implies expenses, which are directly linked to the acquisition and does not include the costs related to the acquisition financing.

If the financing will be provided to the Polish purchaser by a related entity, deductibility of interest may be limited by the transfer pricing and thin capitalization rules. In relation to transfer pricing, generally any interest that is more than the paying party would be expected to pay on an arm's length basis will not be tax deductible.

In relation to the thin capitalization limitations, based on the currently binding regulations, the interest paid to a direct shareholder (a shareholder who directly holds at least 25% of the shares in the borrower) or to the direct sister (where the lender and the borrower have the same direct shareholder directly holding at least 25% of the shares in the lender and in the borrower), the tax deductibility of the interest is limited by the 3:1 debt to share capital ratio.

The Polish Parliament has also approved the planned changes to the thin capitalization limitations (to be applicable to loans granted from 1 January 2015). The changes assume that the thin capitalization limitations will be applicable to all indirectly related entities (based on the 25% threshold) and that the permitted debt to own equity ratio will be reduced to 1:1.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Poland?

Under the Polish Bankruptcy and Rehabilitation Act, the bankruptcy trustee has authority to withdraw from any agreement executed by the insolvent company that was not yet fully performed. This means that the bankruptcy trustee may also withdraw from a subordination agreement. Also, as already indicated above, the concept of subordination is not recognized in execution or bankruptcy



proceedings in Poland and therefore is effective only between the parties to the subordination agreement.

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Saudi Arabia

1. Is there any prohibition on a company incorporated in Saudi Arabia providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

A Saudi Arabian company is prohibited from lending money unless it is a joint stock company and is licensed under the Banking Control Law to conduct "banking business." Therefore, if financial assistance is defined strictly as the lending of money by one company (**Company A**) to another company (**Company B**) to purchase shares in Company A, then that financial assistance would be prohibited.

We are not aware of any provision of Saudi Arabian law that would prohibit Company A from guaranteeing (or providing other support for) a payment obligation of Company B (within the context of a share acquisition or otherwise). However, it is not clear as a matter of Saudi Arabian law whether the enforceability of that guarantee (or other support) depends on there being a legitimate corporate purpose or benefit for Company A. It is possible that the issue of the guarantee (or other support) might be challenged by another shareholder of Company A at any time and by a creditor of Company A in an insolvency on the basis that:

- (a) Company B benefited itself at the expense of Company A; and/or
- (b) the assets of Company A may not be put at risk for the benefit of Company B.
- 2. What are the implications under the corporate benefit laws of Saudi Arabia for a company providing financial assistance?

As noted in the answer to question 1, the enforceability of a guarantee or other support may depend on there being a legitimate corporate purpose or benefit for Company A. It is possible that the issue of the



guarantee (or other support) might be challenged by another shareholder of Company A at any time or by a creditor in an insolvency of Company A on the basis that:

- (a) Company B benefited itself at the expense of Company A; and/or
- (b) the assets of Company A may not be put at risk for the benefit of Company B.

If there is no corporate benefit in Company A granting the guarantee or other support, the directors of Company A may be liable for any losses suffered by Company A in granting that guarantee/support.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most typical types of security taken in acquisition finance transactions over property in Saudi Arabia include:

- (a) for tangible movable property pledge;
- (b) for shares/interests in joint stock companies pledge;
- (c) for proceeds, debts, bank accounts and contractual rights assignment and/or pledge; and
- (d) for real property mortgage.

General Comments

The Commercial Mortgages Regulations

The Commercial Mortgages Regulations were published in the Official Gazette on 7 May 2004, and came into effect 90 days after the date of publication. The Commercial Mortgages Regulations set out,

among other things, certain rules that govern the creation and enforcement of commercial mortgages and pledges that secure identified indebtedness.

Assets capable of "being sold"

Under the Commercial Mortgages Regulations, the item of collateral being mortgaged or pledged must be, among other things, capable of "being sold." It is therefore doubtful whether it is possible to validly mortgage or pledge an intangible item of collateral under the Commercial Mortgages Regulations.

Possession of the assets

Under the Shari'ah, a mortgage or pledge of movable property is validly created only by delivery by the mortgagor or pledgor of actual possession and control of the collateral to the mortgagee or pledgee. If the movable collateral is not delivered into the actual possession of the mortgagee or pledgee (or to an *adl* (which is similar to a security trustee or security agent) acting on its behalf) the mortgage or pledge is incomplete and is revocable in relation to that collateral.

It is a principle of the Shari'ah that everything is possessed in accordance with its nature. Under the Commercial Mortgages Regulations, the mortgagee or pledgee (or an *adl* acting on its behalf) is deemed to have possession of the mortgaged or pledged item if that item is placed under its control or the mortgagee or pledgee (or an *adl* acting on its behalf) is in possession of a "deed representing the pledged or mortgaged item." This modifies the position taken by the Hanbali school of Islamic jurisprudence (which is the school of jurisprudence generally applied by Saudi Arabian courts and judicial committees) that actual possession and control of the mortgaged or pledged item is required.

However, it is not clear whether intangible assets, such as proceeds and debts, are capable of possession under the Commercial Mortgages Regulations. Therefore, the courts and adjudicatory authorities of the Kingdom of Saudi Arabia may determine that the beneficiary of any



purported security over those types of collateral does not have adequate possession or control under Saudi Arabian law to create an irrevocable, valid, binding or enforceable mortgage or pledge (*rahn*) in relation to that collateral.

If a mortgagee or pledgee of, or *adl* in relation to, collateral fails to obtain, ceases to have, or is deemed by a Saudi Arabian court or other adjudicatory authority to have failed to obtain or to have ceased to have, possession and control of the mortgaged or pledged collateral, that mortgagee or pledgee or *adl* will be treated as an ordinary creditor whose obligations will rank in right of payment *pari passu* with all other unsecured obligations of the mortgagor or pledgor.

Existing and identified assets

Under Shari'ah precepts as applied in the Kingdom of Saudi Arabia, a pledge or assignment is effective only in relation to collateral or rights existing on the date of the pledge or assignment and described in the documents giving effect to the pledge or assignment. Therefore, under prevailing concepts in the Kingdom of Saudi Arabia, only collateral and rights existing on the date of the pledge or assignment may be pledged or assigned by the beneficiary of those rights to a creditor of that beneficiary. That pledge or assignment would not be effective in relation to collateral acquired by the mortgagor/pledgor after the effective date of the relevant security documents.

Nature of debt secured

Under Shari'ah precepts as applied in the Kingdom of Saudi Arabia, an assignment of rights or a pledge of property as at a given date of determination secures only identified indebtedness outstanding as at the date of determination, and may not secure advances of indebtedness made after that date of determination, even if those advances are made under the same agreement, and as part of the same overall lending arrangement, as relates to the identified indebtedness outstanding on or prior to that date of determination.

The strict Shari'ah position has been modified in relation to pledges and mortgages that fall within the ambit of the Commercial Mortgages Regulations, which provide that a mortgage or pledge may be security for a debt that is already established or is in the process of being established, provided that the maximum amount secured is stated in the relevant document.

Notice of assignment

Under Shari'ah precepts as applied in the Kingdom of Saudi Arabia, for an assignment by way of security to be effective, relevant third parties must be given notice of, and must consent to, the assignment.

Perfection

The concept of perfecting security under Saudi Arabian law and customary practices of the Kingdom of Saudi Arabia are uncertain, particularly in relation to security interests granted to financial institutions. In the absence of a perfected security interest, it is possible that third party creditors may be able to assert a claim to share in those assets, particularly on insolvency.

Prior claims

Assignments, mortgages and pledges may be subject to any prior claims of other interested parties and creditors.

Interpretation of transaction

A court or other adjudicatory authority applying Saudi Arabian law may not construe an assignment as constituting a nominate contract of *hawala*. If a court or other adjudicatory authority applying Shari'ah precepts as applied in the Kingdom of Saudi Arabia construes an assignment as not constituting a nominate contract of *hawala*, the court or other adjudicatory authority may, under Shari'ah precepts as applied in the Kingdom of Saudi Arabia, construe the assignment as constituting a contract of *wakala* or agency, enforceable in the Kingdom of Saudi Arabia under Saudi Arabian law applicable to contracts of *wakala*.



Enforcement

The ability of a mortgagee or pledgee to enforce a mortgage or pledge (and the manner of that enforcement) is subject to Saudi Arabian law pertaining to the ownership and transfer of assets. Therefore, a term that gives a mortgagee or a pledgee the right to acquire or sell the assets the subject of the mortgage or the pledge on enforcement of the mortgage or the pledge will not be enforceable under Saudi Arabian law, unless that acquisition or sale is in accordance with the Commercial Mortgage Regulations, which provides for the public auction of mortgaged or pledged assets on enforcement (unless otherwise determined by the Saudi Arabian Board of Grievances).

Registration of a pledge

It is unclear what effect registration of a pledge, or the absence of registration, with the Unified Centre for Lien Registration (established by Ministerial Resolution No. 6320 dated 18/6/1425 Hijri (corresponding to 5 August 2004) as amended by Ministerial Resolution No. 267/8/1/1812 dated 19/2/1431 Hijri) may have.

Taxes and duties

The common practice in Saudi Arabia is that lawyers do not provide tax advice. However, we understand that there are no taxes or duties that would be imposed by the Kingdom of Saudi Arabia in relation to the grant of security.

Documents to be in Arabic

To be admissible in evidence before a Saudi Arabian court or other adjudicatory authority, a document must be in Arabic. Saudi Arabian courts or other adjudicatory authorities may accept into evidence certified translations of documents prepared by official registered translators.

Tangible Movable Property

Security over tangible movable property is governed by the Commercial Mortgage Regulations. For a pledge over tangible movable property to be recognized, it must fulfill the following criteria:

- (a) the assets must be identified in the pledge;
- (b) the pledge must be over existing (and not future) assets;
- (c) the pledgee must have physical possession or control over the pledged item; and
- (d) the pledged asset must be capable of being sold.

The pledge may be registered at the Unified Centre for Lien Registration.

Shares/Ownership Interests

To pledge shares in joint stock companies, the pledge must be noted on the company's share register and on the relevant share certificates. The pledge may be registered at the Unified Centre for Lien Registration. In the case of companies listed on the Saudi Stock Exchange (**Tadawul**), Tadawul should be notified so that it can block trading in the relevant shares.

It is not possible to pledge interests in Saudi limited liability companies.

Proceeds, Debts, Bank Accounts and Contractual Rights

While it is common practice in the Kingdom of Saudi Arabia to take an assignment and/or pledge of these intangible assets, as discussed in the "General Comments" section above, it is unclear as a matter of Saudi Arabian law whether an assignment/pledge of these assets is enforceable



Real Property (including usufruct interests)

Under the Real Estate Mortgage Law issued in July 2012 (**Real Estate Mortgage Law**), for a mortgage of real estate to be enforced against a third party, the property must be registered in accordance with the Real Estate Mortgage Law or, if the property is unregistered land, the mortgage must be recorded on the title deed of the land by the competent court or public notary. Most real estate in the Kingdom of Saudi Arabia is unregistered and therefore recording on the title deed is the most common process currently applied.

The Real Estate Mortgage Law is untested. Public notaries in the Kingdom of Saudi Arabia have historically refused to notarize title deeds in favor of commercial banks (often on the basis that the debt which is to be secured may bear interest, i.e. be non-Shari'ah compliant). A few banks have used third party nominees (such as an affiliate/subsidiary company) who do not engage in banking practices to be the nominal beneficiary of the security interest and for whom the public notary could be willing to notarize a title deed.

4. How long, following acquisition of a foreign target company, would it usually take in Saudi Arabia for a Saudi Arabian subsidiary of that foreign target company to grant a guarantee/security?

Whether or not a Saudi Arabian subsidiary of a foreign company may grant a guarantee or security will depend on whether it is authorized to do so under its constitutive documents. That ability would not be affected by the acquisition of its parent company.

5. Are there any restrictions on foreign banks lending to companies in Saudi Arabia? Are interest payments to foreign banks typically subject to withholding tax?

As a general rule, foreign banks (that are not licensed to conduct "banking business" in Saudi Arabia) may lend to Saudi Arabian companies as long as they do not:

- (a) take deposits in Saudi Arabia;
- (b) establish a presence; or
- (c) conduct marketing activities in the country.

As noted above, the common practice in Saudi Arabia is that lawyers do not provide tax advice. However, we understand that withholding tax does apply to certain payments made by companies resident in the Kingdom of Saudi Arabia to non-residents.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Saudi Arabia, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

There are no laws, regulations or orders in the Kingdom of Saudi Arabia dealing with the availability of bank debt procured in relation to a takeover

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

There are currently no laws or regulations in the Kingdom of Saudi Arabia that directly provide for a legal framework to govern corporate bankruptcy or the order of payment in the event of bankruptcy. A reading of the enacted legislation together with the mandates of Shari'ah is likely to result in the following order of payment:

- (a) amounts due to employees or their dependents;
- (b) expenses and debts arising from the liquidation process;
- (c) return of any goods received but for which no payment has been made;



- (d) payments to secured creditors after the assets securing the debt are sold;
- (e) pension contributions and other additional amounts levied as a result of delays in payment of contributions to the General Organization for Social Insurance;
- (f) customs fees;
- (g) unsecured debts and contingent liabilities such as order notes and guarantees; and
- (h) payments to shareholders.

While it is difficult to determine with a perfect degree of certainty the actual order of payment or the interpretative approach that would be adopted by any particular court/liquidator in the Kingdom of Saudi Arabia, we believe that the above-mentioned legal framework would be the most likely to be employed.

8. Is interest on debt incurred to acquire a company in Saudi Arabia deductible from earning for tax purposes? Are there any thin capitalization thresholds?

As noted above, the common practice in Saudi Arabia is that lawyers do not provide tax advice. However, we understand that certain deductions may be claimed for loan fees incurred in relation to the earning of income subject to tax. Saudi Arabian law does not contain any specific provisions on thin capitalization.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Saudi Arabia?

As noted in the answer to question 7, corporate liquidators and courts have some degree of discretion in apportioning payments among the various stakeholders in a liquidation. Whether a liquidator will honor a contractual subordination arrangement therefore depends on the facts of a particular liquidation and the particular liquidator.

A contractual subordination arrangement is unlikely to be honored by a liquidator if it purports to alter the mandatory order of payment on insolvency or the rights of a prior-ranked secured creditor. Also, if the document containing the subordination arrangement is open to challenge on grounds affecting its enforceability (e.g., a guarantee (incorporating a subordination provision) which is unenforceable due to lack of sufficient corporate benefit), the subordination arrangement contained within that document is unlikely to be honored by a liquidator.

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Singapore

 Is there any prohibition on a company incorporated in Singapore providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Section 76(1) of the Companies Act, Chapter 50 of Singapore (**Companies Act**) prohibits a company from giving any financial assistance for the purpose of, or in connection with, the acquisition by any person of shares in that company or shares in the holding company of that company (**Unlawful Financial Assistance**). Section 76(1)(a) states:

"Except as otherwise expressly provided by this Act, a company shall not, whether directly or indirectly, give any financial assistance for the purpose of, or in connection with:

- (a) the acquisition by any person, whether before or at the same time as the giving of the financial assistance, of (i) shares or units of shares in the company; or (ii) shares or units of shares in a holding company of the company; or
- (b) the proposed acquisition by any person of (i) shares or units of shares in the company; or (ii) shares or units of shares in a holding company of the company."

The giving of Unlawful Financial Assistance includes (but is not limited to) financial assistance by means of the making of a loan, the giving of a guarantee, the provision of security, the release of an obligation or the release of a debt.

Section 76(3) goes on to provide that a company shall be taken to have given financial assistance for the purpose of an acquisition or proposed acquisition referred to in Section 76(1)(a) (referred to as the "relevant purpose") if:

- (a) the company gave the financial assistance for purposes that included the relevant purpose; and
- (b) the relevant purpose was a substantial purpose of the giving of the financial assistance.

The Singapore courts will examine the relevant arrangements to determine if there is any Unlawful Financial Assistance or if the relevant arrangements are camouflaging any unlawful financial assistance. One of the key questions the courts may ask is whether the parties would have entered into the acquisition of the shares but for the arrangement in question.

Sections 76(9A), 76(9B) and 76(10) set out the different whitewash procedures that may be followed to enable a company to provide financial assistance for the acquisition of its shares or shares in its holding company, assuming that there are no other relevant exemptions. The different whitewash procedures can briefly be described as follows:

- (a) director-approved financial assistance under Section 76(9A);
- (b) shareholder-approved financial assistance under Section 76(9B); and
- (c) court-sanctioned whitewash procedure under Section 76(10).

Sections 76(8) and (9) contain a list of items that are expressly carved out from the financial assistance prohibition.

The whitewash procedures are set out in the Appendix.

A contract or transaction made in contravention of Section 76(1)(a) shall be void if it falls within the type of contract or transaction listed in Section 76A(1). All other contracts or transactions in contravention of Section 76(1)(a) shall be voidable at the option of the company. A "related" contract or transaction is also voidable. Section 76A(14) defines what "related" means in this context. Where a company gives



financial assistance, any contract or transaction engaged in as a result of, or by means of, or in relation to, the financial assistance is deemed to be a related transaction. Also, if there is a breach of Section 76(1), each officer of the company in default shall be guilty of an offense and liable on conviction to a fine not exceeding SGD20,000 and/or to imprisonment for a term not exceeding three years.

Before a company can avoid the relevant contract or transaction, notice in writing must be given to the other parties to the contract or transaction. This notice may be given by the company itself or, if the court so authorizes, by a member of the company, a trustee for the debenture holders, a debenture holder or a director. However, a contract or a transaction is not voidable if it is entered into in reliance on a certificate stating that the requirements of Section 76(9A), 76(9B) or 76(10) (as the case may be) has been complied with. This certificate must have been signed by two directors or a director and a secretary. This does not apply if the person relying on the certificate became aware before the contract was made, or the transaction was engaged in, that the requirements of Section 76(9A), 76(9B) or 76(10) (as the case may be) had not been complied with.

2. What are the implications under the corporate benefit laws of Singapore for a company providing financial assistance?

In Singapore, directors of a company must act in the interests of the company. Section 157 of the Companies Act provides that a director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his/her office. The phrase "act honestly" has been interpreted to mean "acting bona fide in the interests of the company in the performance of the functions attaching to the office of director."

Directors in Singapore also owe fiduciary duties to the company, as a matter of common law, to act in the interests of the company.

When considering the provision of financial assistance for the acquisition of the company's shares, directors must continue to act in the interests of the company. It should also be noted that corporate benefit should accrue to the company and not just to another company in the group. What amounts to commercial benefit depends on the facts of each case. This is ultimately a question for the court to decide (if the matter is brought to court).

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most typical types of security granted over property in Singapore include:

- (a) for scrip shares, share mortgages which may be legal or equitable;
- (b) for scripless shares, a statutory assignment or charge in a prescribed form under Section 130N of the Companies Act or a common law charge/assignment;
- (c) for other assets, fixed and floating charges in the form of debentures; and
- (d) for land, real property mortgages which may be statutory or equitable.

Scrip shares

A key difference between an equitable mortgage of shares and a legal mortgage of shares is that with an equitable mortgage, the mortgagee has possession of the share certificates in respect of those shares mortgaged to it without having the shares registered in its name (or in the name of its nominee) With a legal mortgage, however, the shares are actually transferred to the mortgagee or its nominee and registered in the name of the mortgagee or its nominee (as the case may be).



Scripless shares – statutory assignment/charge

To create a statutory assignment or a statutory charge, both the chargor and the chargee must have a direct account with the Central Depository (Pte) Limited (CDP), which operates the Central Depository System for the holding and transfer of book-entry securities.

In the case of an assignment, the CDP will immediately, on receipt of the instrument of assignment (which is in a prescribed form), by way of an off-market transaction (i.e., a transaction effected outside the Securities Exchange), transfer the book-entry securities to the assignee. In the case of a charge, the CDP will immediately, on receipt of the instrument of charge (which is in a prescribed form), register the instrument in a register of charges maintained by the CDP.

After the shares have been the assigned or charged, the assignor or the chargor (as the case may be) cannot create any further security interest in any of the book-entry securities in favor of any other person. Any further assignment or charge will be void. However, the assignee or the chargee may sub-charge the book-entry securities.

Scripless shares - common law charge

Regulation 23A of the Companies (Central Depository System) Regulations allows for the creation of a common law charge (i.e., not registrable with the CDP) between sub-account holders of the same depository agent. The Regulation states:

"nothing in Section 130N of the Companies Act shall be construed as precluding a sub-account holder from creating under any rule of law any security interest in book-entry securities in favor of any other subaccount holder who maintains a sub-account for such book-entry securities with the same depository agent as the sub-account holder."

Therefore, if both chargor and chargee have sub-accounts with the same depository agent, the chargor can create a common law assignment or charge in favor of the chargee instead of the statutory assignment or charge prescribed by Section 130N of the Companies Act.

Registration

A company incorporated under the Companies Act that creates a charge to which Section 131 of the Companies Act applies must lodge a statement of particulars of charge with the Accounting and Corporate Authority of Singapore (ACRA) for registration within 30 days after creation of the charge. ⁴⁸ If s 131 is not complied with the charge will, so far as any security on the company's property or undertaking is conferred by that charge, be void against a liquidator and any creditor of the company. Registrable charges created by a foreign company registered under the Companies Act over its property in Singapore are also subject to these registration requirements.

Charges to which Section 131 of the Companies Act applies are:

- (a) a charge to secure any issue of debentures;
- (b) a charge on uncalled share capital of a company;
- (c) a charge on shares of a subsidiary of a company which are owned by the company;
- (d) a charge or an assignment created or evidenced by an instrument, which, if executed by an individual, would require registration as a bill of sale;
- (e) a charge on land wherever situated or any interest therein;
- (f) a charge on book debts of the company;
- (g) a floating charge on the undertaking or property of a company;

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⁴⁸ This may be extended by 7 days or further periods as the Registrar may from time to time allow if the instrument creating the charge is executed or made in a place outside Singapore.



- (h) a charge on calls made but not paid;
- (i) a charge on a ship or aircraft or any share in a ship or aircraft; and
- (j) a charge on goodwill, on a patent or license under a patent, on a trademark, or on a copyright or a license under a copyright.

Apart from registration under the Companies Act, there may be additional registration requirements depending on the nature of the charged asset. For example, a charge or mortgage over a ship must also be registered with the Registry of Ships.

Stamp duty

Where the mortgage involves shares or land, stamp duty up to a maximum of SGD500 is payable if that mortgage is executed in Singapore, or if executed outside of Singapore, when it is received in Singapore. For a legal mortgage of shares or land, stamp duty is calculated at SGD4 for every SGD1,000 or any part thereof being a security (other than an equitable mortgage) for the payment or repayment of money, subject to a maximum of SGD500. For an equitable mortgage of shares or land, stamp duty is calculated at SGD2 for every SGD1,000 or any part thereof being a security for the payment or repayment of money, subject to a maximum of SGD500.

4. How long, following acquisition of a foreign target company, would it usually take in Singapore for a Singaporean subsidiary of that foreign company to grant a guarantee/security?

In Singapore, if the whitewash procedure is completed before the acquisition of the foreign target company takes place, the guarantee/security may be granted by the Singaporean subsidiary at the same time as the acquisition occurs.

The procedure under Section 76(10) of the Companies Act will require no less than 35 days to complete. In practice, a longer period may be needed to coordinate the required steps in the procedure,

ensure that all documents are in order and that the necessary filings are done. The 35 day period assumes that the directors are cooperative and are available to sign and/or pass the relevant resolutions and statements.

The procedure under Section 76(9B) should take less than two weeks to complete and the procedure under Section 76(9A) should take an even shorter period (as no shareholders' resolutions are required to be passed). However, the procedure under Section 76(9A) can be used only if the value of the guarantee/security, together with any other financial assistance previously provided which remains outstanding, does not exceed 10% of the aggregate total paid-up capital and reserves of the Singapore subsidiary granting the guarantee/security.

If the directors are uncomfortable about providing solvency statements, a mandatory requirement under Sections 76(9A) and (9B), then the longer process under Section 76(10) must be undertaken. Nowadays, most companies would usually adopt the procedure under Section 76(9A) or 76(9B) (depending on whether the amount of financial assistance exceeds 10% of the aggregate total paid-up capital and reserves of the company) as the process is shorter and simpler.

5. Are there any restrictions on foreign banks lending to companies in Singapore? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

Under section 5(1) of the Moneylenders Act, Chapter 188 of Singapore (**Moneylenders Act**), no person shall carry on or hold himself out in any way as carrying on the business of moneylending in Singapore, whether as principal or as agent unless:

- (a) he is authorized to do so by a license;
- (b) he is an excluded moneylender; or
- (c) he is an exempt moneylender.



- "Excluded moneylender" is defined in the Moneylenders Act as:
- (a) any body corporate, incorporated or empowered by an Act of Parliament to lend money in accordance with that Act;
- (b) any person licensed, approved, registered or otherwise regulated by the Authority under any other written law, to the extent that such person is permitted or authorized to lend money or is not prohibited from lending money under that other written law;
- (c) any society registered as a credit society under the Co-operative Societies Act;
- (d) any pawnbroker licensed under the Pawnbrokers Act;
- (e) any person who:
 - (i) lends monies solely to his employees as a benefit of employment;
 - (ii) lends money solely to accredited investors within the meaning of section 4A of the Securities and Futures Act;
 - (iii) lends money solely to:
 - (A) corporations;
 - (B) limited liability partnerships;
 - (C) trustees or trustee-managers, as the case may be, of business trusts for the purposes of the business trusts;
 - (D) trustees of real estate investment trusts for the purposes of the real estate investment trusts, or who carries on any combination of such activities or services; or
- (f) any person carrying on any business not having for its primary object the lending of money in the course of which and for the purposes whereof he lends money.

Where the entity involved is a foreign bank, it is usually more appropriate for the foreign bank to obtain a banking license from the Monetary Authority of Singapore (MAS) rather than a license under the Moneylenders Act as a banking license would allow it to expand its activities beyond lending. A foreign bank that has a license from the MAS will be an excluded moneylender under the Moneylenders Act.

Section 4 of the Banking Act, Chapter 19 of Singapore (**Banking Act**) provides that no banking business shall be transacted in Singapore except by a company that is in possession of a valid license granted under the Banking Act. "Banking business" is defined in the Banking Act as the business of receiving money on current or deposit account, paying and collecting cheques drawn by or paid in by customers, the making of advances to customers and includes such other business as the MAS may prescribe for the purposes of the Banking Act.

However, lending to a Singapore company on a one-off or very limited basis will in most cases probably not qualify as carrying on "banking business".

Withholding tax

Interest payments out of Singapore to a non-resident person are generally subject to withholding tax under the Income Tax Act, Chapter 134 of Singapore. Where the non-resident does not derive the interest income from business operations carried out in Singapore, the withholding tax rate is 15%. Where the non-resident derives the interest income from business operations carried out in Singapore, the withholding tax rate is 17%. Rates of withholding tax with respect to interest may be reduced under Singapore's various double tax treaties.



6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Singapore, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Under rule 3.5 of the Singapore Code on Takeovers and Mergers (**Takeover Code**), where the offer is for cash or involves an element of cash, the announcement of an offer should include an unconditional confirmation by a financial adviser or by an appropriate third party that the offeror has sufficient resources available to satisfy full acceptance of the offer.

Under the notes to rule 3.5 of the Takeover Code, the Securities Industry Council of Singapore may require evidence to support a statement that resources are available to satisfy the offeror's obligations. The Securities Industry Council of Singapore may also require evidence that the offeror has sufficient resources to complete the purchase of shares which gives rise to the obligations.

Under rule 23.8 of the Takeover Code, where the offer is for cash or includes an element of cash, the offer document must also include an unconditional confirmation by an appropriate third party (for example, the offeror's banker or financial adviser) that resources are available to the offeror that are sufficient to satisfy full acceptance of the offer. However, the party confirming that resources are available will not be expected to produce the cash if, in giving the confirmation, it acted responsibly and took all reasonable steps to assure itself that the cash would be available to satisfy full acceptance of the offer. The Securities Industry Council of Singapore reserves the right to require evidence to support the confirmation.

Generally, under rule 4 of the Takeover Code, where the offeror has announced a firm intention to make an offer, it cannot withdraw the offer without the Securities Industry Council of Singapore's consent, unless the offer has been subject to the prior fulfillment of a specific condition and that condition has not been met.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

In general, the order of ranking of creditors in descending order of priority when the company is wound up is:

- (a) secured creditors (except holders of debentures under any floating charge) in respect of those assets over which securities have been granted by the company to them;
- (b) preferred creditors who are entitled to be paid, *pari passu*, as set out in Section 328(1) of the Companies Act as follows:
 - (i) first, cost and expenses of the winding up (including taxed costs of the applicant in relation to the winding up order, remuneration of the liquidator and the costs of any audit);
 - (ii) second, all wages or salary including any amount payable by way of allowance or reimbursement or commission under any contract of employment, award or agreement regulating conditions of employment of any employee subject to a limit;
 - (iii) third, the amount due to an employee as a retrenchment benefit or ex gratia payment under any contract of employment, award or agreement that regulates conditions of employment subject to a limit;
 - (iv) fourth, all amounts due in respect of work injury compensation under the Work Injury Compensation Act, Chapter 354 of Singapore, accrued before, on or after the commencement of the winding up;
 - (v) fifth, all amounts due in respect of contributions payable during the 12 months before, on or after the commencement of the winding up by the company as the employer of any person under any written law relating to employees' superannuation, provident funds or under any scheme of



- superannuation which is an approved scheme under the law relating to income tax;
- (vi) sixth, all remuneration payable to any employee in respect of vacation leave, or, in the case of his/her death, to any other person in his/her right, accrued in respect of any period before, on or after the commencement of the winding up; and
- (vii) seventh, the amount of all tax assessed and all goods and services tax due under any written law before the commencement of the winding up or assessed at any time before the time fixed for the proving of debts has expired;

(Note: The amount payable under paragraphs (ii) and [iii] above will not exceed an amount that is equivalent to five months' salary whether for time or piecework in respect of services rendered by the employee to the company or SGD7,500, whichever is the lesser amount. Under Section 328(5) of the Companies Act, creditors under paragraphs (iv) and (vii)above do not rank ahead of holders of debentures under any floating charge in priority.)

- (c) holders of debentures under any floating charge;
- (d) ordinary unsecured creditors, pari passu; and,
- (e) shareholders

As can be seen above, debt holders are generally given priority over equity holders by law. It should also be noted that if a registrable charge (see the answer to question 3 above) is not registered within the prescribed time, it becomes void against the liquidator and any creditor of the company. In other words, for practical purposes, the chargee is unsecured if the company goes into liquidation.

The order of priority of charges may also be affected by any intercreditor agreements or similar agreements and arrangements between the secured creditors.

8. Is interest on debt incurred to acquire a company in Singapore deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Generally, interest on debt incurred to acquire a company in Singapore will not be deductible. Interest payments on the debt will only be deductible against taxable income generated from the relevant acquisition. Where the debt is incurred to acquire the shares of a Singapore tax resident company, the dividend income from the relevant shares will be exempt from tax, in which case the interest expense will not be deductible.

There are no thin capitalization rules in Singapore.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Singapore?

There is no legislation in Singapore on the validity of contractual subordination in the event of the insolvency of the debtor company. Therefore, case law will determine the position in Singapore in relation to this question.

In the 2006 English case of *Re SSSL Realisations (2002) Ltd (in liquidation) and another company* [2006] EWCA Civ 7, the English Court of Appeal gave weight to the commercial expectation of the parties and held that "if group companies enter into subordination agreements of this nature with their creditors while solvent, they and their creditors should be held to the bargain when the event for which the agreement was intended to provide (insolvency) occurs."

The court held that a subordination agreement is valid and binding. It is likely that the same position will be taken in Singapore.



Appendix- Relevant sections of the Companies Act Section 76(9A)

Nothing in Section 76(1) prohibits the giving by a company of financial assistance for the purpose of, or in connection with, an acquisition or proposed acquisition by a person of shares or units of shares in the company or in a holding company of the company if:

- (a) the amount of the financial assistance, together with any other financial assistance given by the company under this subsection repayment of which remains outstanding, would not exceed 10% of the aggregate of:
 - (i) the total paid-up capital of the company; and
 - (ii) the reserves of the company,
 - as disclosed in the most recent financial statements of the company;
- (b) the company receives fair value in connection with the financial assistance;
- (c) the board of directors of the company passes a resolution that:
 - (i) the company should give the assistance;
 - (ii) giving the assistance is in the best interests of the company; and
 - (iii) the terms and conditions under which the assistance is given are fair and reasonable to the company;
- (d) the resolution sets out in full the grounds for the directors' conclusions;
- (e) all the directors of the company make a solvency statement in relation to the giving of the financial assistance;

- (f) within 10 business days of providing the financial assistance, the company sends to each member a notice containing particulars of:
 - (i) the class and number of shares or units of shares in respect of which the financial assistance was or is to be given;
 - (ii) the consideration paid or payable for those shares or units of shares;
 - (iii) the identity of the person receiving the financial assistance and, if that person is not the beneficial owner of those shares or units of shares, the identity of the beneficial owner; and
 - (iv) the nature and, if quantifiable, the amount of the financial assistance; and
- (g) not later than the business day next following the day when the notice referred to in paragraph (f) is sent to members of the company, the company lodges with the Registrar of Companies a copy of that notice and a copy of the solvency statement referred to in paragraph (e).

Section 76(9B)

Nothing in Section 76(1) prohibits a company from giving financial assistance for the purpose of, or in connection with, an acquisition or proposed acquisition by a person of shares or units of shares in the company or in a holding company of the company if:

- (a) the board of directors of the company passes a resolution that:
 - (i) the company should give the assistance;
 - (ii) giving the assistance is in the best interest of the company;and
 - (iii) the terms and conditions under which the assistance is given are fair and reasonable to the company;



- (b) the resolution sets out in full the grounds for the directors' conclusions;
- (c) all the directors of the company make a solvency statement in relation to the giving of the financial assistance;
- (d) not later than the business day next following the day when the resolution referred to in paragraph (a) is passed, the company sends to each member having the right to vote on the resolution referred to in paragraph (e) a notice containing particulars of:
 - (i) the directors' resolution referred to in paragraph (a);
 - (ii) the class and number of shares or units of shares in respect of which the financial assistance is to be given;
 - (iii) the consideration payable for those shares or units of shares;
 - (iv) the identity of the person receiving the financial assistance and, if that person is not the beneficial owner of those shares or units of shares, the identity of the beneficial owner;
 - (v) the nature and, if quantifiable, the amount of the financial assistance; and
 - (vi) such further information and explanation as may be necessary to enable a reasonable member to understand the nature and implications for the company and its members of the proposed transaction;
- (e) a resolution is passed:
 - (i) by all the members of the company present and voting either in person or by proxy at the relevant meeting; or
 - (ii) if the resolution is proposed to be passed by written means, by all the members of the company, to give that assistance;

- (f) not later than the business day following the day the resolution referred to in paragraph (e) is passed, the company lodges with the Registrar of Companies a copy of that resolution and a copy of the solvency statement referred to in paragraph (c); and
- (g) the financial assistance is given not more than 12 months after the resolution referred to in paragraph (e) is passed.

Section 76(10)

Nothing in Section 76(1) prohibits the giving by a company of financial assistance for the purpose of, or in connection with, an acquisition or proposed acquisition by a person of shares or units of shares in the company or in a holding company of the company if:

- (a) the company, by special resolution, resolves to give financial assistance for the purpose of or in connection with, that acquisition;
- (b) where:
 - (i) the company is a subsidiary of a listed corporation; or
 - (ii) the company is not a subsidiary of a listed corporation but is a subsidiary whose ultimate holding company is incorporated in Singapore, the listed corporation or the ultimate holding company, as the case may be, has, by special resolution, approved the giving of the financial assistance;
- (c) the notice specifying the intention to propose the resolution referred to in paragraph (a) as a special resolution sets out:
 - (i) particulars of the financial assistance proposed to be given and the reasons for the proposal to give that assistance; and
 - (ii) the effect that the giving of the financial assistance would have on the financial position of the company and, where the company is included in a group of corporations consisting of a



holding company and a subsidiary or subsidiaries, the effect that the giving of the financial assistance would have on the financial position of the group of corporations, and is accompanied by a copy of a statement made in accordance with a resolution of the directors, setting out the names of any directors who voted against the resolution and the reasons why they so voted, and signed by not less than two directors, stating whether, in the opinion of the directors who voted in favor of the resolution, after taking into account the financial position of the company (including future liabilities and contingent liabilities of the company), the giving of the financial assistance would likely prejudice materially the interest of the creditors or members of the company or any class of those creditors or members;

- (d) the notice specifying the intention to propose the resolution referred to in paragraph (b) as a special resolution is accompanied by a copy of the notice, and a copy of the statement referred to in paragraph (c);
- (e) not later than the day following the day the notice referred to in paragraph (c) is dispatched to members of the company and there is lodged with the Registrar of Companies a copy of that notice and a copy of the statement that accompanied that notice;
- (f) the notice referred to in paragraph (c) and a copy of the statement referred to in that paragraph are sent to:
 - (i) all members of the company;
 - (ii) all trustees for debenture holders of the company; and
 - (iii) if there are no trustees for, or for a particular class of, debenture holders of the company, all debenture holders, or all debenture holders of that class, as the case may be, of the company whose names are, at the time the notice is dispatched, known to the company;

- (g) the notice referred to in paragraph (d) and the accompanying documents are sent to:
 - (i) all members of the listed corporation or of the ultimate holding company;
 - (ii) all trustees for debenture holders of the listed corporation or of the ultimate holding company; and
 - (iii) if there are no trustees for, or for a particular class of, debenture holders of the listed corporation or of the ultimate holding company, all debenture holders or debenture holders of that class, as the case may be, of the listed corporation or of the ultimate holding company whose names are, at the time the notice is dispatched, known to the listed corporation or the ultimate holding company;
- (h) within 21 days after the date on which the resolution referred to in paragraph (a) is passed or, in a case to which paragraph (b) applies, the date on which the resolution referred to in that paragraph is passed, whichever is later, a notice:
 - (i) setting out the terms of the resolution referred to in paragraph (a); and
 - (ii) stating that any of the persons referred to in subsection (12) may, within the period referred to in that subsection, make an application to the Court opposing the giving of the financial assistance, is published in a daily newspaper circulating generally in Singapore;
- (i) no application opposing the giving of the financial assistance is made within the period of 21 days after the publication of the notice referred to in (h) above or, if such an application or applications has or have been made, the application or each of the applications has been withdrawn or the Court has approved the giving of the financial assistance; and



- (i) the financial assistance is given in accordance with the terms of the resolution referred to in paragraph (a) and not earlier than:
 - (i) in a case to which sub-paragraph (ii) does not apply, the expiration of the period referred to in subsection (12); or
 - (ii) if an application or applications has or have been filed with the Court within that period:
 - where the application or each of the applications has been withdrawn – the withdrawal of the application or of the last of the applications to be withdrawn; or
 - b. in any other case the decision of the Court on the application or applications.

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South Africa

1. Is there any prohibition on a company incorporated in South Africa providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

The South African Companies Act, 2008 (Companies Act) governs the position where a South African company provides financial assistance:

- (a) in connection with the acquisition or issue of shares or other securities in itself or in a related or inter-related company (including a parent); and
- (b) more broadly, to or for the benefit of any related or inter-related company, or to or for the benefit of, any of its directors or officers or any related or inter-related company.

Under Section 44 of the Companies Act, a South African company may provide financial assistance in connection with the acquisition or issue of its shares or its other securities or of any related or interrelated company (including its parent company), either direct or ultimate, if:

- (a) the company's constitutional documents do not prohibit the provision of that financial assistance; and
- (b) the financial assistance is approved by the company's board of directors and by its shareholders by special resolution.

Under Section 45 of the Companies Act, a South African company may provide financial assistance to or for the benefit of a related or inter-related company, or to or for the benefit of a director or other officer of itself or of a related or inter-related company, if:

(a) the company's constitutional documents do not prohibit the provision of that financial assistance; and



(b) the financial assistance is approved by the shareholders (by a special majority of 75%) (**Shareholder Special Resolution**) and by the company's board of directors.

Two companies are related if:

- (a) either of them controls the other;
- (b) one is a subsidiary of the other; or
- (c) a person directly or indirectly controls each of them (i.e. they have a common "parent").

Three or more companies are inter-related if there are two related companies, and one company is related to one of them, and so on, in an unbroken series.

In addition to the requirement of shareholders' approval by way of a special resolution, the board of directors may only authorize the provision of financial assistance if:

- (a) immediately after the provision of the financial assistance, the company will meet the solvency and liquidity test; and
- (b) the directors are satisfied that the terms on which the financial assistance is to be provided are fair and reasonable to the company.

A Shareholder Special Resolution is not required if the financial assistance has been given under an employee share scheme (which meets the requirements of the Companies Act).

A company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time:

(a) the assets of the company (fairly valued) are equal to, or exceed, the liabilities of the company (also fairly valued); and

(b) it reasonably appears that the company will be able to pay its debts as they become due in the course of business for a period of 12 months after the date on which the test is considered.

An agreement or resolution to provide any financial assistance is void to the extent that it is inconsistent with Section 44 or 45 of the Companies Act, or the company's constitutional documents.

2. What are the implications under the corporate benefit laws of South Africa for a company providing financial assistance?

There are no corporate benefit laws in South Africa. However, the directors of a company must always observe their fiduciary duties and act in the best interests of the company.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g. notarization, registration, government approval, etc.)? Is any tax duty payable on grants of security, and if so, what is the basis for this calculation?

South African law broadly categorizes property as either movable property or immovable property, both of which may be tangible or intangible.

Immovable property

Immovable property (which includes land, improvements on land and long term leases over land) is encumbered by way of mortgage bond. A mortgage bond must be registered over the relevant immovable property in the Deeds Registry Office by a conveyancer. Once registered, it creates a real right of security over the relevant asset, giving a preference on insolvency.

There are no stamp or other taxes payable in relation to a mortgage bond, but there is a prescribed conveyancing fee payable to the



conveyancer registering the mortgage bond and nominal Deeds Registry Office fees.

Movable property

Movable property (which includes plant and equipment, vehicles, shares, other securities, receivables and claims and rights under an agreement) can be encumbered in a number of different ways. The most common forms of security used in South Africa to create encumbrances over movable property are set out below.

Notarial bonds

Notarial bonds can be used for tangible movable property and can be either of a general nature or of a special nature.

A general notarial bond is a mortgage granted by a debtor in favor of a lender as security for a debt or other obligation over all of the debtor's tangible movable property. Even if registered, it does not give a preference on insolvency without a confirming judgment and perfection of the security.

A special notarial bond is a mortgage granted by a debtor in favor of a lender as security for a debt or other obligation over specific tangible movable property, specifically described and identified in the notarial bond deed (so that it is readily identifiable by a third party). Once registered, it creates a real right of security over the asset and therefore has a preference on insolvency.

A notarial bond must be notarially executed before a notary and registered at the Deeds Registry Office. There are no stamp or other taxes payable in relation to a notarial bond but there is a prescribed notarial fee payable to the notary and nominal Deeds Registry Office fees

Pledges

A pledge is a type of mortgage of movable property given by a borrower (pledgor) in favor of a lender (pledgee) as security for a debt or other obligation. A pledge can also be used in relation to tangible movable property.

In order for a pledge to be validly created between the pledgor and the pledgee, an agreement to that effect must be reached together with actual delivery of the pledged movable property to the pledgee or its agent. The pledgor retains full title to the pledged movable property subject to the pledgee's security interest.

A pledge need not be registered nor notarized and need not comply with any formal requirements, but will only be valid if the property is actually delivered to, and remains in the possession and under the control of, the pledgee. As such, a pledge may not be appropriate in many instances, but once given and once the relevant asset has been delivered to the pledgee, it creates a real right of security over the asset and a preference on insolvency. There are no stamp or other taxes payable in relation to a pledge nor any prescribed fee tariffs.

Cession in security

A cession in security (cession in *securitatem debiti*) is created by the debtor (the cedent) granting security by way of cession over intangible movable property in the creditor's (the cessionary's) favor. Title to the property remains with the cedent (as with a pledge) subject to the cessionary's security interest.

Cessions in security can be used for intangible movable property such as shares and other securities, receivables and claims and rights under agreements. A cession in security takes the form of a pledge. It need not be registered nor notarized nor comply with any formal requirements. As the property is intangible, physical delivery of the property is achieved by the cession agreement itself and therefore cessions in security are widely used for a variety of assets and asset classes. Once entered into, a cession in security creates a real right of security over the asset. There are no stamp or other taxes payable in relation to cessions in security nor are there any prescribed fee tariffs.



Other

Certain specific types of assets created by statute, such as intellectual property rights, mining rights and the like, can only validly be encumbered by way of statutory prescribed forms of security.

4. How long, following acquisition of a foreign target company, would it usually take in South Africa for a South African subsidiary of that foreign target company to grant a guarantee/security?

There is no definitive time period within which a South African subsidiary may grant security following the acquisition.

Subject to the particular nature of any given transaction, it is common practice for a subsidiary to deliver the security document granting the guarantee/security concurrently on closing of the acquisition. This would, in the ordinary course, be agreed between the buyer and the seller in advance

That being said, exchange control approval will be required at the time that the guarantee/security is granted, as it:

- "(1) may give rise to a claim for payment against the company by a person resident outside the Republic."
- 5. Are there any restrictions on foreign banks lending to companies in South Africa? Are interest payments to foreign banks typically subject to withholding tax?

Exchange control approval

In order for any South African company to borrow money abroad (whether from a foreign bank or another non South African entity), exchange control approval is required.

Withholding tax

A cross-border withholding tax was introduced in South Africa (by Sections 50A to 50H of the Income Tax Act, 1962 (**Income Tax Act**)) and took effect from 1 March 2015. Under those sections of the Income Tax Act, withholding tax must be withheld and paid over to the South African Revenue Service (SARS) by any person paying South African sourced interest to a foreign person (i.e. a non-resident that is not a controlled foreign company⁴⁹).

Interest is considered to be from a South African source if incurred by a resident (unless the interest is attributable to a business of the resident outside South Africa) or is received from the utilization or application of funds in South Africa.

The foreign person is ultimately liable for the tax on its interest income. However, section 50E of the Income Tax Act contains a withholding mechanism that requires the payer of the South African sourced interest, which is often a South African taxpayer, to the foreign person to withhold the tax when the interest is paid.

The rate at which the tax should be withheld is 15% of the gross interest amount paid to the foreign person. The rate may be reduced if a Double Taxation Agreement (**DTA**) has been entered into between South Africa and the state of residence of the recipient of the interest. Most treaty provisions contain specific allocations or limitations of the source country's taxing right to interest income of the resident of the

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⁴⁹ Subject to certain exceptions and exemptions contained in the definition of a controlled foreign company (**CFC**) contained in section 9D of the Income Tax Act, a CFC is any foreign company where more than 50% of the total participation rights in that foreign company are directly or indirectly held, or more than 50% of the voting rights in that foreign company are directly or indirectly exercisable, by one or more residents of South Africa (i.e. a foreign company controlled by South African residents). Section 9D of the Income Tax Act is an anti-avoidance provision aimed at preventing South African residents from excluding tainted forms of taxable income from the South African taxing jurisdiction through investment in CFCs.



other state. The application of the relevant article of the DTA dealing with interest varies from case to case and requires consideration of factors such as beneficial ownership and the presence of the recipient in the source country.

South Africa is expected to renegotiate its existing treaties in light of the new 15% withholding tax

6. If a takeover bid, which relies on bank debt, is made for a publically listed company in South Africa, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

If the takeover bid, relying on bank debt, contains a cash consideration portion, the Takeover Regulations issued under the Companies Act require that an irrevocable, unconditional guarantee is issued by a South African bank, or that an irrevocable, unconditional confirmation is given by a third party that sufficient cash is held in escrow in favor of the holders of the relevant shares for the sole purpose of fully satisfying the cash offer commitment.

The guarantee or confirmation that sufficient cash is held in escrow must be delivered to the Takeover Regulation Panel at the time the offer is made with the powers to exercise the guarantee or confirmation, in whatever manner is required, if the acquirer fails to pay the consideration.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

In South Africa, insolvency is primarily governed by the South African Insolvency Act, 1936 (Insolvency Act). The winding-up and reorganization of companies is also governed by the Companies Act,

1973,⁵⁰ which incorporates by reference portions of the Insolvency Act in dealing with companies that cannot pay their debts.

The Insolvency Act ranks various claims against the insolvent estate, that is to say, sets out the order in which the claims must be paid and to what extent each must be paid. The estate, for the purposes of distribution, consists of the proceeds of both encumbered and unencumbered assets

The proceeds of each encumbered asset are applied to pay the claim (or claims) secured by that asset. Any balance remaining after the payment of secured creditors is combined with the proceeds of the unencumbered assets to pay the remaining creditors. These monies, known as the "free residue," are applied firstly to satisfy the claims in their order of preference and secondly to pay the claims of concurrent creditors (i.e. unsecured creditors).

A creditor who holds security for its claim in the form of a real right and whose security is properly perfected has a secured claim over the property constituting its security.

A secured claim must be paid in priority to any other claim from the proceeds of the realization of the secured property, after the deduction of liquidation costs. Where more than one secured creditor has security over the same asset, the creditor granted security earlier in time has a higher-ranking claim in respect of that asset.

If the amount realized from sale of the property over which the secured creditor has a secured claim is insufficient to satisfy the debt, the balance owing to the secured creditor will be a concurrent claim.

There are certain statutory preferences (such as taxes) that will be paid after secured creditors but before concurrent creditors.

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⁵⁰ Under Schedule 5 to the 2008 Companies Act (Transitional Arrangements), chapter 14 of the Companies Act 1973 (relating to winding up and insolvency) continues to apply.



To the extent that there is any free residue after all concurrent claims have been paid, it will be distributed to the shareholders.

8. Is interest on debt incurred to acquire a company in South Africa deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Interest on debt

As of 1 January 2013, interest incurred on debt to finance the acquisition of shares in a South African company is deductible for tax purposes, where a South African company acquires at least a 70% equity shareholding in another South African operating company. An "operating company" includes any company that carries on business continuously by providing goods or services for consideration.

Thin capitalization

Previously, the South African thin capitalization provisions applied where financial assistance granted by a connected person that was a non-resident or a non-resident that held at least 25% of the equity shares capital/voting rights in a South African company, exceeded a 3:1 debt to fixed capital ratio (calculated with reference to the proportion of equity held). In those circumstances, the excessive portion of interest was disallowed as a deduction from the taxable income of that South African company.

As of 1 April 2012, thin capitalization is treated as part of the general transfer pricing provisions under the Income Tax Act and the test no longer applies a debt-to-fixed capital ratio. Rather it is necessary to undertake an analysis to determine whether the financial assistance granted is excessive in relation to financial assistance that would have been granted had the investor and the connected person been independent persons dealing at arm's length. These changes are intended to be compatible with the rules set out by the Organisation for Economic Co-operation and Development (OECD).

Non-tax reasons may exist for preferring equity, for example, where a low debt-to-equity ratio is favored. This factor is often the reason for companies choosing hybrid funding.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in South Africa?

Whether or not the liquidator will give effect to a subordination arrangement depends on whether the subordination agreement is framed as:

- (a) a simple priority of payment (which the liquidator will not be bound by); or
- (b) an agreement that certain (subordinated) debts do not fall due for payment until other (high ranking) debts have been discharged (which the liquidator will be bound by).

Accordingly, in order to be honored by a liquidator, a subordination agreement should:

- (a) amount to more than a simple order of priority for payment, and rather make the payment of amounts to the subordinated creditors conditional on the discharge of all debts owed to the primary creditor; and
- (b) be effective prior to a winding up, and not only in the event of a winding up.

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Spain

 Is there any prohibition on a company incorporated in Spain providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Financial assistance prohibition

Under Spanish corporate law, it is unlawful for a company to provide financial assistance to facilitate the acquisition of its own shares or the shares in its parent company. It is also unlawful for a private limited liability company (*Sociedades Limitadas*) (**Private Company**), as further explained below, to facilitate the acquisition of shares in other group companies. Transactions carried out in breach of this prohibition are null and void under Section 6.3 of the Spanish Civil Code. The aim of this prohibition is to avoid target companies assuming the acquisition debt to the detriment of minority shareholders, creditors and other interested third parties.

Companies Act

This prohibition is regulated under Section 143.2 of the Companies Act (*Ley de Sociedades de Capital*) (**Companies Act**) for private limited liability companies and under Section 150 of the Companies Act for public limited liability companies (*Sociedades Anónimas*) (**Public Company**). The wording is intentionally broad to capture any kind of financial aid granted by a company to facilitate the acquisition of its own shares, the shares of its parent company or, if applicable, the shares in other group companies.

Section 143.2 of the Companies Act states:

"Private limited liability companies may not advance funds, grant loans, guarantees or security, or provide financial assistance for the acquisition of their own shares or shares issued by any company belonging to their group." On the other hand, Section 150 of the Companies Act states, in its first paragraph:

"Public limited liability companies may not advance funds, grant loans, guarantees or security, or provide any type of financial assistance for the acquisition of its shares or its parent company's shares by a third party."

Exceptions

Section 150 also sets out two exceptions in paragraphs two and three that read as follows:

- "2. The prohibition established in [paragraph one above] shall not apply to transactions that intend to facilitate the acquisition by the company's employees of shares in the company or in any other company belonging to the same group.
- 3. The prohibition established in paragraph one above shall not apply to transactions carried out by banks and other financial institutions that are conducted within the scope of their ordinary business in pursuit of their corporate purpose, and the cost of which is booked against the company's freely disposable assets."

A Spanish company may nevertheless guarantee or secure the payment obligations arising from any tranches of the acquisition facility or any additional facilities granted to finance purposes other than the acquisition price, costs and expenses, such as the refinancing of pre-existing indebtedness of the target or target group (to the extent that that indebtedness does not qualify as acquisition debt), working capital requirements and future investments.

Before Act 3/2009, of 3 April, on Structural Changes in Trading Companies

Before Act 3/2009, of 3 April, on Structural Changes in Trading Companies (*Ley 3/2009 de 3 de abril, sobre modificaciones estructurales de las sociedades mercantiles*) (**Act 3/2009**) was



enacted, leveraged mergers (those by virtue of which the acquisition debt was pushed down to the target company) were regarded as transactions which could potentially fall within the financial assistance prohibition. However, the legal community understood that the actual risk of the merger being challenged was low as long as the resulting company could pay all its debts as they matured. This was because, although leveraged mergers involved some uncertainty due to the risk of being challenged on the basis of the financial assistance prohibition given the broad scope of the definition, all interests protected by that prohibition (mainly those of minority shareholders, creditors, and employees) were already being sufficiently protected by the procedures established under the corporate legislation applicable to merger processes (such as information rights and reinforced legal majorities for minority shareholders, objection rights for creditors and information rights for employees).

On the basis of this interpretation, a large number of leveraged mergers were implemented and registered with the Commercial Registry in Spain prior to 2009. This interpretation was also applied to other types of "corporate transactions", such as reductions of share capital, spin-offs, segregations, and distributions of dividends, based on the rationale that corporate law itself, through the legal provisions applicable to each of these corporate transactions, contained mechanisms to effectively control the activity of corporate management, therefore protecting the form and legality of these corporate actions as well as any third party interests at stake.

Requirements introduced by Act 3/2009, of 3 April, on Structural Changes in Trading Companies

Section 35 of Act 3/2009 specifically regulates merger processes in which one of the companies involved in the merger has obtained financing during the three preceding years to acquire the shares or assets of another company also involved in the merger process.

Section 35 of Act 3/2009 states:

"In mergers involving two or more companies, where one of them incurred debt in the three years immediately preceding the merger to acquire control of another or to purchase assets thereof essential to its normal operations or of importance for the value of its equity, the following rules shall apply:

- (i) the merger project must specify the resources and dates on which the resulting company is expected to repay the debts incurred to acquire control of the assets;
- (ii) the directors' report on the merger project must specify the reasons justifying acquisition of control or the assets as well, as appropriate, as the merger operation. It must also contain an economic and financial plan listing the resources and a description of the objectives sought; and
- (iii) the experts' report on the merger proposal must contain an opinion stating whether the items referred to in the two preceding items are reasonable and determining the possible existence of financial assistance. Under the circumstances referred to in this article, the expert report shall be requisite, even when the merger agreement is unanimously adopted."

Issues with the new requirements

Although this section was meant to bring certainty to leveraged mergers by expressly allowing them under certain circumstances (in line with the 2006 amendment to the EU Second Directive), the wording of Section 35 leaves the matter unclear. Section 35 of Act 3/2009 requires that, in the case of a leveraged merger, certain information must be included by the directors in the merger project and the directors' report. It also requires that an independent expert must issue a report stating whether the information included in the merger project and the directors' report is reasonable and confirm whether there is financial assistance. However, Section 35 remains silent about the consequences if the independent expert's report



concludes that there is financial assistance and/or that the information contained in the merger project and/or the directors' report is not reasonable. Further, Section 35 does not expressly state that a clean independent expert's report concluding that there is no financial assistance and that the information contained in the merger project is reasonable amounts to a successful "whitewash" procedure in relation to the relevant merger and that, consequently, the risk of unlawful financial assistance and its various consequences may be clearly disregarded.

In view of the above, obtaining a clean report from an independent expert that concludes that the information included in the merger project and the directors' report is reasonable and stating that the merger does not involve financial assistance is a key step to be able to carry out the leveraged merger. This, in turn, implies that it will not be possible to know upfront if the merger process can be completed and it will be necessary to wait until the report of the independent expert is finally issued to make that determination.

Expectations in relation to reports of auditors and financial experts

Section 35 of Act 3/2009 has been heavily criticized for wrongly imposing on auditors and financial experts the duty of interpreting a purely legal issue such as the potential existence of unlawful financial assistance. There are few precedents of leveraged mergers registered after the enactment of Act 3/2009 and the full text of the independent experts' reports are not publicly available at the Commercial Registry. However, it is reasonable to expect that independent experts will not provide a legal analysis in relation to the existence of financial assistance (as they do not have the necessary legal expertise to do so). They will instead provide a financial analysis (similar to the one provided when issuing reports on financial statements) of the information provided by the directors in the merger project and the directors' report. This financial analysis will assess whether it is reasonable to conclude that the resulting company will be able to generate sufficient cash flow (from ordinary operating revenues and

other sources such as tax credits, divestment of certain assets or recourse to other financial resources) to repay the debts (including the acquisition debt) when they fall due without negatively affecting the ordinary course of the surviving company's business due to overindebtedness or illiquidity which could lead to an insolvency situation.

Fines for breach by directors

In addition to the nullity of transactions carried out in breach of the financial assistance prohibition, a breach may be sanctioned by the imposition of a fine of up to the par value of the shares acquired with financial assistance. A breach may also attract directors' liability under Section 157 Companies Act. For these purposes, Section 157 considers "directors" to be not only the members of the board of directors, but also the company's managers (*directivos*) and representatives (*personas con poder de representación*). Directors of the parent company inducing the breach of the financial assistance prohibition by the subsidiary may also face liability in accordance with Section 157 of the Companies Act.

2. What are the implications under the corporate benefit laws of Spain for a company providing financial assistance?

In Spain, the concept of corporate benefit relates to the fiduciary duty of diligence and loyalty imposed on directors under Sections 225 and 226 of the Companies Act. These sections provide that directors of a company must always perform their duties with the diligence of an orderly businessman and must act as loyal representatives, in defense of the corporate interest, which is interpreted as the interest, or the benefit, of the company.

When considering providing any aid for the acquisition of the company's shares or the shares issued by any company belonging to its corporate group (in the case of a Private Company) or the shares issued by its parent company (in the case of Public Company), the



directors of the assisting company must act in the interest of that assisting company.

In the absence of one or more managing directors with broad powers, the granting of security/guarantee by a Spanish company will require a board of directors' resolution (unless the management body of a company is, for example, a sole director). If the security/guarantee is to be granted by a Private Company to secure/guarantee obligations incurred by its shareholders or directors, a shareholders' resolution approving the grant of the relevant security/guarantee would also be required.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most commonly granted security interest over shares and assets in Spain and the general technical requirements for their validity, perfection and enforceability are set out below.

Mortgage over land and buildings

The mortgage agreement must be:

- (a) executed before a notary public as a public deed (*escritura pública*); and
- (b) registered with the Land Registry.

Possessory pledge (prenda posesoria) over receivables

The pledge agreement must be executed before a notary public as a deed (*póliza*) or a public deed (*escritura pública*).

A notice of creation of the pledge must be delivered to the relevant debtor.

The pledge agreement must be updated on a periodic basis to include the proper identification of any future receivables purported to be pledged by means of the execution of an additional deed (*póliza*) or public deed (*escritura pública*) before a notary public.

Possessory pledge (*prenda posesoria*) over credit rights arising from bank account agreements

The pledge agreement must be executed before a notary public as a deed (póliza) or a public deed (escritura pública).

A notice of creation of the pledge must be delivered to the depository bank.

Possessory pledge over shares in a public limited liability company (sociedad anónima)

Pledge over shares represented by share certificates

The pledge agreement must be executed before a public notary as a deed (*póliza*) or a public deed (*escritura pública*) unless the security is susceptible of being granted as a financial pledge. If the pledge is granted subject to the specific regulation under RDL 5/2005, which implements the provisions of Directive 2002/47/EC on Financial Collateral Arrangements in Spain, no public document is required. In any other case, the pledge must be granted by means of a public document executed before a notary public.

The share certificates (duly endorsed in favor of the pledgee) must be delivered to the beneficiary of the pledge or to a third party acting as a custodian of the collateral.

Market standard practice also requires that:

(a) the creation of the pledge be annotated in the shareholders' registry-book of the issuing company;



- (b) the secretary of the board of directors issues and delivers a certificate to the pledgee evidencing that the pledge has been annotated in the shareholders' registry-book; and
- (c) the creation of the pledge be annotated in the ownership title (i.e. the document evidencing the acquisition of the shares by the pledgor).

It is advisable to review the company's bylaws to check whether there are any limitations on, or requirements for, the creation or enforcement of the pledge (e.g., restrictions on transfer or who can exercise voting or dividend rights).

Pledge over shares represented by book entries (anotaciones en cuenta).

The pledge agreement must be executed before a public notary as a deed (*póliza*) or a public deed (*escritura pública*) (unless the security is susceptible of being granted as a financial pledge under RDL 5/2005, in which case a private document would, in principle, suffice).

The pledge must be recorded in the special registry kept by the relevant entity participating in the Spanish clearing and settlement system in charge of the bookkeeping entries for the relevant shares. On registration, that entity also:

- (i) carries out the breakdown and freezing of the shares (which means that the entity in charge of the bookkeeping entries will not allow the transfer of the shares or the execution of any other transaction in relation to the shares); and
- (ii) issues a certificate (*certificado de legitimación*) confirming the registration of the pledge over the shares in favor of the pledgee, all in accordance with Royal Decree 116/1992, of 14 February, on representation of securities by means of book entries and clearance and settlement of stock exchange transactions.

It is advisable to review the company's bylaws to check whether there are any limitations on, or requirements for, the creation or enforcement of the pledge (e.g. restrictions on transfer or who can exercise voting or dividend rights).

Possessory pledge over quotas in a private limited liability company (sociedad limitada)

The pledge agreement must be executed before a notary public as a deed (póliza) or a public deed (escritura pública).

A notice of creation of the pledge must be served on the company whose quotas are pledged.

Market standard practice also requires that:

- (a) the creation of the pledge be annotated in the quotaholders' registry-book of the issuing company;
- (b) the secretary of the board of directors issues and delivers a certificate to the pledgee evidencing that the pledge has been annotated in the quotaholders' registry-book; and
- (c) the creation of the pledge be annotated in the ownership title (i.e. the document evidencing the acquisition of the quotas by the pledgor).

It is advisable to review the company's bylaws to check whether there are any limitations on, or requirements for, the creation or enforcement of the pledge (e.g., restrictions on transfer or who can exercise voting or dividend rights).

Chattel mortgage (*hipoteca mobiliaria*) over certain movable assets

The movable assets over which a chattel mortgage can be granted include commercial establishments, motor vehicles, tramways, train



carriages, intellectual and industrial property, aircrafts and industrial machinery.

The mortgage agreement must be executed before a notary public as a public deed (*escritura pública*).

The mortgage deed must be registered with the Movable Assets Registry (*Registro de Bienes Muebles*).

Pledge without dispossession (*prenda sin desplazamiento*) over certain movable assets

The movable assets over which a chattel mortgage can be granted include agricultural machinery, equipment, inventory, stored merchandise, raw materials, and receivables.

The pledge agreement must be executed as a deed (*póliza*) or public deed (*escritura pública*).

The pledge agreement must be registered with the Movable Assets Registry (*Registro de Bienes Muebles*).

Stamp duty

No stamp duty payment obligation will be triggered by the granting of security interests that are not subject to registration with a public registry (e.g., possessory pledges over shares, quotas, receivables, bank accounts, etc.).

A stamp duty obligation will be triggered by the granting of real estate mortgages, chattel mortgages and pledges without dispossession executed as notarial deeds (*escrituras públicas*). Stamp duty however is not levied on pledges without dispossession executed as deeds (*pólizas*).

As a general rule, stamp duty will be payable at the rate of 1%. However, most of the autonomous regions have enforced their own legislation and have different rates that range from 0.75 % to 2 %. The

taxable amount would be the maximum secured amount under the relevant mortgage/pledge.

4. How long, following acquisition of a foreign target company, would it usually take in Spain for a Spanish subsidiary of that foreign target company to grant a guarantee/security?

As long as the granting of the relevant guarantee/security does not constitute unlawful financial assistance in Spain, there is no waiting period requirement following the acquisition of a foreign target company in relation to the granting of a guarantee/security by its Spanish subsidiary. If the granting of the relevant guarantee or security would constitute unlawful financial assistance, the mere lapse of time will not eliminate the risk. (It could be argued, however, that the risk may be reduced if the granting of the guarantee/ security is delayed by more than three years as the transaction may avoid compliance with Section 35 of Act 3/2009 although even in those circumstances, the risk might not be totally disregarded).

If a leveraged merger involving the Spanish subsidiary is required to achieve the debt push down, the merger will need to comply with the requirements of Section 35 of Act 3/2009, if carried out within three years of the acquisition.

In relation to the timing to grant the relevant security/guarantee, it will generally depend on whether specific corporate resolutions need to be passed by the Spanish company. If specific corporate resolutions are required, it will depend on the required timing under the company's bylaws and applicable legislation to properly convene and hold the relevant directors' or shareholder meetings and the time needed to execute, notarize and register, if applicable, the relevant security.



5. Are there any restrictions on foreign banks lending to companies in Spain? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

In Spain the activity of solely lending money, without the carrying out of any additional banking activity (such as raising reimbursable deposits from the public), does not require the relevant lender to obtain a prior authorization from the Spanish banking authorities. However, the recent Bank of Spain's Circular 4/2012, dated 25 April, regarding the ruling on communications by residents in Spain with respect to their economic transactions and the foreign balances of their financial assets and liabilities (Circular 4/2012, de 25 de abril, sobre normas para la comunicación por los residents en España de las transacciones económicas y los saldos de activos y pasivos financieros con el exterior) establishes that Spanish companies engaging in transactions with non-residents in Spain, must regularly inform the Bank of Spain about:

- (a) the transactions performed with non-residents (e.g., foreign banks or foreign entities); and
- (b) the corresponding balances of the foreign financial assets and liabilities of those non-residents

Withholding tax

A withholding tax may be levied on interest paid to a foreign lender (including foreign banks). There is no withholding on interest paid to an entity or an individual resident of an EU member state if that state does not qualify as a tax haven. Non-EU residents (entities or individuals) are subject to a 21 % withholding tax. This rate may be lowered subject to tax treaty provisions. The Spanish Non-Resident Income Tax Act also sets out the following exemptions for interest obtained by a non-resident other than through a permanent establishment:

- (a) Spanish public debt;
- (b) interest of non-resident accounts;
- (c) interest derived from bonds issued by Spanish securitization funds; and
- (d) preferred shares, to the extent that certain requirements are met.
- 6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Spain, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Spanish regulations on Takeover Bids for securities (**TOB**) are currently governed by the Securities Market Act 24/1988, dated 28 July (*Ley 24/1988*, *de 28 de Julio*, *Ley de Mercado de Valores*) and mainly by Royal Decree 1066/2007, dated 27 July on Takeover Procedures (*Real Decreto 1066/2007*, *de 27 de julio*, *sobre el régimen de las ofertas públicas de adquisición de valores*) (RD 1066/2007), which incorporates Directive 2004/25/EC into Spanish Law.

RD 1066/2007 establishes that a TOB can either be formalized as:

- (i) a cash sale and purchase (compraventa);
- (ii) a swap (permuta); or
- (iii) an exchange of securities (*canje de valores*); or as a combination of the above.

There are no specific requirements regulating the certainty of the availability of the bank debt when a TOB, which relies on bank debt, is made for a publicly listed company. However, if payment for the TOB is to be made in cash, totally or partially, and irrespective of the origin of the funds (i.e., regardless of whether the TOB is funded by equity or debt), the bidder must provide evidence to the Spanish Securities & Exchange Commission (*Comisión Nacional del Mercado*



de Valores) of the creation of a guarantee that guarantees the complete payment of the TOB price to the potential sellers. This evidence must consist either of a guarantee issued by a credit entity or a cash deposit constituted by the bidder in a credit entity.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Under the provisions of the Insolvency Act 22/2003, dated 9 July (*Ley 22/2003, de 9 de Julio, Ley Concursal*) (**Insolvency Act**), in the event of liquidation of the insolvent company, its creditors will be paid off as established in the liquidation plan (which is drafted by the insolvency administrator (*administrador concursal*)) and in accordance with the order of priority of creditors established in the Insolvency Act. That order of priority is as follows:

- (a) creditors holding secured claims (such as a real estate mortgage or a pledge over assets owned by the insolvent company) (*créditos con privilegio especial*);
- (b) creditors holding claims against the insolvency estate (*créditos contra la masa*), which include certain claims owed to the debtor's employees, claims for expenses and costs generated during the insolvency proceedings (including the insolvency administrator's fees and the fees corresponding to the legal counsel handling the insolvency proceedings) and claims generated after the commencement of the insolvency proceedings;
- (c) unsecured creditors holding claims benefitting from a general preference under Section 91 of the Insolvency Act (*créditos con privilegio general*), which include, amongst others, certain salary claims, tax and social security claims up to certain percentages, claims deriving from non-contractual civil liabilities and, if applicable, 50% of the amount of the claim held by the creditor that filed for insolvency, if any;

- (d) unsecured creditors holding unsecured or "ordinary" claims (*créditos ordinarios*) (which includes any claims not otherwise classified under the Insolvency Act), which will be paid, on a *pro rata* basis, only once any other claims (except for subordinated claims) have been fully satisfied;
- (e) subordinated creditors holding subordinated claims (*créditos subordinados*), which include:
 - those claims that are communicated by the relevant creditor to the insolvency administrator once the applicable deadline for making that communication has elapsed;
 - (ii) claims that have been contractually agreed to be subordinated;
 - (iii) claims resulting from interest and fines; and
 - (iv) claims held by group companies or shareholders (provided they hold more than 10% of the share capital or 5% if it is a listed company) that derive from loan agreements, as well as claims held by the directors of the company; and
- (f) shareholders or equity holders.

As a general rule, debt holders are given priority over equity holders by law. Subordinated claims are paid (in the order specified in (e) above) only after all other more senior claims have been settled in full.

It is the insolvency administrator who qualifies each claim. If there is a dispute between the creditor and the administrator, a parallel and ancillary piece of litigation, called insolvency incident (*incidente concursal*), may be handled before the Commercial Court, which would ultimately decide on that qualification.



8. Is interest on debt incurred to acquire a company in Spain deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Spanish corporate taxpayers can only deduct their net finance costs up to the limit of 30 % of their operating income. However, a EUR 1 million deduction in net financial expenses is allowed without any limitation (**Spanish Interest Barrier Rules**). Any amount in excess of EUR 1 million can be carried forward during the subsequent 18 tax periods, together with the net financial expenses of the relevant tax period until that excess is effectively deducted. If the net financial expenses in a tax year do not reach the 30 % limit, then the difference between the net financial expenses and the 30 % limit will be added to the 30 % limit during the five subsequent years until the difference is effectively deducted. Spanish Interest Barrier Rules do not apply to the following entities:

- (a) credit and insurance entities; and
- (b) entities which are liquidated, unless that event takes places as a result of a restructuring transaction applying the Spanish reorganization roll over tax regime, or if it is carried out within a group of entities under certain circumstances.

In relation to intra-group financial expenses, there is a new specific provision providing that intra-group financial expenses related to intra-group leveraged acquisitions/share capital increases are not generally deductible unless there are valid business reasons for doing so.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Spain?

Whether contractual subordination will be honored by the insolvency administrator depends on the nature of the contractual subordination. There are mainly two types of contractual subordination that may be applicable as set out below.

Subordination with respect to any other claims against the debtor

Article 92 of the Insolvency Act contemplates the subordination of those claims that have been considered as subordinated under a contractual agreement between the insolvent debtor and a creditor by which the subordinated claim is contractually subordinated to any other claims against the debtor.

This type of contractual subordination will be honored by the insolvency administrator.

Subordination only with respect to certain specific creditors/claims

The Insolvency Act does not contemplate the subordination of claims where that subordination has been agreed only in relation to certain specific claims against the debtor.

As argued by the majority of Spanish legal scholarship, the insolvency administrator may not recognize this type of contractual subordination. Therefore, it is standard practice to contemplate in the relevant agreements the mechanisms or sharing arrangements to be followed among the relevant lenders in the event that the mezzanine/junior lenders are paid prior to or *pari passu* with the senior creditors in the context of the insolvency proceedings of the borrower. In any case, there is little case law addressing this matter and subordinated claims are very rarely settled within insolvency proceedings in Spain.

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Sweden

1. Is there any prohibition on a company incorporated in Sweden providing financial assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

The General Loan Prohibition

Definition

According to Ch. 21, Section 1 of the Swedish Companies Act, (*Aktiebolagslagen*) (**Companies Act**) a Swedish limited liability company (*aktiebolag*, AB) may not provide monetary loans to:

- (a) a person holding shares in the company or in a company in the same company group;
- (b) a board member or deputy board member, or managing director or deputy managing director of the company or of a company in the same company group;
- (c) a spouse, cohabitant, parent, sibling or other close relative of a person referred to in (a) and (b) above; or
- (d) a legal entity over which a person referred to in (a) to (c) above (alone or together with other persons referred to in (a) to (c)) exercises a controlling influence.

Purpose

This prohibition against providing loans to persons closely related to an AB (**Restricted Circle**) is usually referred to as the "**General Loan Prohibition**." The purpose of the General Loan Prohibition is twofold, namely to:

- (a) protect the creditors of an AB; and
- (b) prevent tax evasion.



Security

The General Loan Prohibition applies not only to the provision of monetary loans, but also to the provision of security for monetary loans i.e., an AB may not provide security for a loan made to a member of the Restricted Circle by a third party.

While the general rule prohibits the Swedish AB from providing loans to a Swedish parent company as this is prohibited under "a person holding shares in the company or in a company in the same company group", there are specific exemptions for loans within a company group described below.

Company group

For the purposes of the General Loan Prohibition, a company group is defined as a group of companies the parent company of which is a Swedish AB. This means that if a Swedish AB's parent company is, for example, a company domiciled in the United States, the Swedish AB may not provide the parent company with a loan. This would be a loan to a shareholder in violation of (a) above. However, the Swedish AB would be free to loan money to a board member of its US parent company or to a shareholder of that company (as the US parent would not be regarded as a company "in the same company group"). If the Swedish AB's parent company had instead also been a Swedish AB, any loan provided to a shareholder or board member of that company would be prohibited.

It is only the domicile of the parent company that is relevant for the determination of whether a company group is a Swedish group according to the definition in the Companies Act. Therefore, the General Loan Prohibition applies in full to loans provided to shareholders in, and a board member or managing director of, a Swedish AB's subsidiary, irrespective of where the subsidiary has its domicile.

Exemptions to the General Loan Prohibition

There are certain exemptions to the General Loan Prohibition. The most important exemptions are that the General Loan Prohibition does not apply if:

- (a) the loan is provided to a company in the same company group as the AB providing the loan (**Group Exemption**); or
- (b) the AB provides the loan for purely commercial reasons and the loan is intended to be used exclusively in the borrower's business (Commercial Loan Exemption).

In relation to the Group Exemption, a company group for the purposes of this Section of the Companies Act is a group of companies in which the parent company is a company domiciled within the European Economic Area (EEA). Therefore, this definition of company group is wider than the definition of company group used for the purposes of the General Loan Prohibition in Ch. 21, Section 1 of the Companies Act, and the intention is to exempt loans within a group of companies and to not discriminate against company groups where the parent company is located within the EEA but outside Sweden.

In relation to the Commercial Loan Exemption, the loan must directly or indirectly be of benefit to the business of the lending AB for this exemption to apply. This can be the case, for example, if the loan is intended to finance a business in which the lending AB will take part or in which the lending AB otherwise has an interest. The second requirement, that the loan be used exclusively in the borrower's business, is intended primarily to prevent loans for private use. Therefore, "the borrower's business" is not intended to be construed restrictively. A cash pool arrangement, in which companies domiciled outside of the EEA participate, is a typical example of a credit arrangement that usually falls within the scope of the Commercial Loan Exemption. It should also be noted that the business of the borrower must be "ongoing." Therefore, the Commercial Loan



Exemption is not available if the loan is provided in order for the borrower to start a new line of business.

In relation to a loan made to a shareholder of the lending AB, there is a third exemption to the General Loan Prohibition. The General Loan Prohibition does not apply if the borrowing shareholder, alone or together with closely related persons, holds shares representing less than one % of the AB's total share capital. Further, a holder of shares in an investment fund as defined in the Investment Funds Act (lagen om investeringsfonder) is not regarded as a shareholder for the purposes of the General Loan Prohibition.

Therefore, although the scope of the General Loan Prohibition may seem extensive, because of the ample exemptions to it, it is not as restrictive as it may seem at first.

The Acquisition Financing Prohibition

Ch. 21, Section 5 of the Companies Act provides that a Swedish AB may not advance funds or provide loans, or provide security for loans for the purpose of financing the borrower's (or a closely related person's) acquisition of shares in the lending AB or a company higher up the structure in the same company group (defined as a group of companies in which the parent company is a Swedish AB). This prohibition against financial assistance is usually referred to as the "Acquisition Financing Prohibition."

The Acquisition Financing Prohibition means that a Swedish AB may not in any way provide means to be used for the acquisition of shares in the lending AB or any company higher up the structure in the same group as the lending AB. However, the Acquisition Financing Prohibition does not prevent an AB from financing an acquisition of the AB's business or a subsidiary of the AB.

The exemptions to the General Loan Prohibition mentioned in the section titled "Exemptions to the General Loan Prohibition" above do not apply to the Acquisition Financing Prohibition.

Exemption Granted by the Tax Agency

The Tax Agency (*Skatteverket*) (**Tax Agency**) may under certain circumstances grant exemptions from the General Loan Prohibition and the Acquisition Financing Prohibition. Exemption from the General Loan Prohibition may only be granted if there are exceptional reasons (*synnerliga omständighete*) to do so. Exemption from the Acquisition Financing Prohibition may be obtained if there are special reasons (*särskilda skäl*). Public companies, however, are not able to obtain an exemption from the Acquisition Financing Prohibition.

If the borrowing AB is a company licensed by the Swedish Financial Supervisory Authority (*Finansinspektionen*), the Swedish Financial Supervisory Authority and not the Tax Agency will consider the AB's application for exemption.

Legal Consequences of a Violation

If an AB provides a loan or other means of financial assistance in violation of the General Loan Prohibition or the Acquisition Financing Prohibition, that loan is invalid. This means that the borrower is obliged to repay any funds received from the lending AB, regardless of whether the borrower acted in good faith or not.

If, on the other hand, a Swedish company provides security in violation of the General Loan Prohibition or the Acquisition Financing Prohibition, that provision of security is invalid only if the beneficiary of the security realized or should have realized that the provision of security was illegal.

Further, a board member or a managing director, or, under certain circumstances, a shareholder, who intentionally or by gross negligence has participated in a resolution to provide an illegal loan may be liable to pay damages to the lending AB.

The intentional or grossly negligent participation in a breach of the General Loan Prohibition or the Acquisition Loan Prohibition is a



criminal offense and may be punished by a fine or imprisonment of up to a maximum of one year.

In addition, under a recent Court of Appeals case, the lending company may be issued with a company fine for the prohibited loan.

2. What are the implications under the corporate benefit laws of Sweden for a company providing financial assistance?

Transactions by which a company's capital is decreased are governed by Chapter 17 of the Companies Act and are generally referred to as value transfer transactions and described in the Act as "any business event as a consequence of which the company's assets are reduced and which is not of a purely commercial nature for the company."

Permitted value transfers are:

- (a) the distribution of profits;
- (b) acquisition of the company's own shares; and
- (c) reduction of the share capital or statutory reserve for repayment to the shareholders.

There are specific procedural steps to be taken in order to perform any of the above transactions.

Also, any transaction that will cause a decrease in the company's equity and that is not being performed at arm's length is considered to be a value transfer. For example, if a loan taken by a third party is interest free or extending a credit or otherwise if the applicable interest rate is lower than the market rate. The creditworthiness of the borrower also needs to be considered. To the extent that it cannot be expected that the borrower will be able to repay the loan, it would constitute a value transfer.

If there is no corporate benefit for the company, the financial assistance provided would be treated as a distribution of assets and would be unlawful unless the company has distributable reserves available and sufficient coverage of the company's restricted equity (i.e. equity that may not be paid as a dividend including the registered share capital, the reserve fund, revaluation reserve and the share of equity reserve).

A company's board of directors has a duty to the shareholders of the company to protect the company's capital and the board can, in certain circumstances, be made liable where the capital of the company decreases, in particular where the transaction has not been conducted at arm's length. If funds are transferred unlawfully from the company, the receiving party may be liable to repay the sums. Shareholders and board members as well as managers may be ordered to repay any deficiency to the company.

Chapter 25 of the Companies Act states that the board has a duty to draw up an additional balance sheet (*kontrollbalansräkning*) and in some cases even liquidate the company if the company's equity falls below 50 % of its registered share capital. If the board members do not take necessary action, they may become personally liable for debts incurred by the company.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Floating Charge (also known as a Chattel Mortgage)

A floating charge is a specific lien that makes it possible for companies to use their operating assets (chattels) as security. A floating charge is not tied to certain specific property at a given time. Instead, the underlying property may change over time.



The security is perfected through delivery of a floating charge certificate (*inteckningsbrev*) by the pledgor to the pledgee. This certificate represents a specified value of the pledgor's chattels and serves as security for the debt. A floating charge certificate can either be issued in written form or electronically, by registration in the floating charge register kept by the Swedish Companies Registration Office (*Bolagsverket*). There is stamp duty payable to the Companies Registrations Office for taking out a new floating charge. The amount payable is calculated at the rate of 1 % of the mortgaged amount. The floating charge certificates that are issued can be reused for future security without incurring any additional stamp duties.

Bank accounts

A bank account pledge is perfected through notification to the bank. This notification is free of charge. For the pledge to be effective against other creditors, the debtor must not have any right whatsoever to withdraw money from the bank account that is pledged. For practical reasons, the pledge is therefore left unperfected until a certain triggering event e.g., default occurs in relation to operating accounts

Securities deposits

Securities in a deposit account (*depå*) can be pledged to the bank that keeps the deposit or to another lender. The pledge is perfected by notification to the bank. It is sufficient that the notice states that the deposit, including future securities, is pledged. Therefore, the securities need not be specified. As a result of the notice, the bank keeping the deposit cannot release any securities without the permission of the pledgee.

Registered shares

Euroclear Sweden AB (Euroclear) maintains the share registers for public limited liability companies. A pledge over shares that are registered with Euroclear must also be registered with Euroclear. The registration is free.

For shares registered with a custodian (*förvaltare*), e.g. shares that are kept in a securities deposit, the rules described above in relation to securities deposits apply.

Unregistered shares

Liens on unregistered shares are perfected by a notation in the company's share ledger and by delivery of the physical share certificates duly endorsed in blank. There are no costs involved. No public registration, notarization, etc. is required.

Promissory notes and claims

The pledging of non-negotiable promissory notes is perfected by notification to the original debtor under the pledge. By analogous application a security interest over other forms of claims is also perfected by notification to the original debtor.

Pledging of a negotiable promissory note is perfected through delivery of the promissory note to the pledgee duly endorsed in blank.

Real estate and site-leasehold rights

The rules concerning mortgaging of real estate are also applicable to site-leasehold rights and (albeit rather unusual) waterfall rights. Three-dimensional properties (real estate that may be divided vertically) also fall under the same rules. The security is perfected through delivery of the mortgage certificate (*pantbrev*) by the mortgagor to the mortgagee. This certificate represents a specified value of the mortgagor's real estate and serves as security for the debt. A mortgage certificate can either be issued in written form or electronically, by registration in the mortgage certificate register kept by the Swedish Land Registry (*Lantmäteriet*). The cost for an application for a mortgage certificate consists of a stamp duty amount equivalent to 2 % of the face value of the mortgage and payable to the Land Registry.



4. How long, following acquisition of a foreign target company, would it usually take in Sweden for a local subsidiary of such company to grant a guarantee/security?

As mentioned in the answer to question 1, the Acquisition Financing Prohibition means that a Swedish AB may not in any way provide assistance for the acquisition of shares in the lending AB or a company higher up the structure in the same group as the lending AB.

The exemptions to the General Loan Prohibition mentioned above do not apply to the Acquisition Financing Prohibition and there are no whitewash procedures under Swedish law.

The prohibition will apply if a loan granted to the acquiring entity has been secured by the target company's assets in immediate connection with the completion of the acquisition such that the third party lender did not take any actual credit risk on the acquisition vehicle. However, if the third party lender has taken an actual credit risk, it may be possible for the local subsidiary to provide security some time after the closing of the acquisition. The more time that has passed after the closing of the acquisition, the better, but the important assessment is the actual risk taken.

It is possible to allow the borrower to refinance after a certain period. The local subsidiary can provide security for the refinancing. It is important, however, that the refinancing is not mandatory but merely an option for the borrower. There is no statutory or precedent waiting period before the borrower uses the refinancing option, but, again, the more time that has passed, the better.

5. Are there any restrictions on foreign banks lending to companies in Sweden? Are interest payments to foreign banks typically subject to withholding tax?

There are no specific restrictions on foreign banks lending to companies in Sweden from outside of Sweden. Regular provision of services in Sweden or targeting the Swedish market, among other things, by marketing services in Sweden, however, requires a license. If the foreign bank is EEA-based and wants to conduct lending activities in Sweden, it can act under an EEA "passport." Banks from outside the EEA may only conduct banking business from a branch in Sweden and are required to hold a permit from the Swedish regulatory authorities.

Sweden imposes no withholding tax on interest payments.

6. If a takeover bid which, relies on bank debt, is made for a publicly listed company in Sweden, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Sweden has three regulated markets, the largest of which is Nasdaq OMX.

The Nasdaq OMX Take Over Rules (**Take Over Rules**) will apply to all takeover bids for listed companies traded on Nasdaq OMX. The Take Over Rules stipulate the fundamental principle that a bidder may only announce a cash offer after making sure that the offer can be fully paid and after taking all reasonable measures to ensure that payments by any other means are performed. The bidder must also ensure that adequate financing is available for the entire term of the offer. A press release containing the details of the financing arrangements must be released as soon as possible.

The bidder may include a condition in its bid that must be met for the bidder to proceed with the transaction. The condition has to be drafted so that it can be objectively decided if it has been met or not. Therefore, the condition may not be worded so that the bidder has discretion to decide or influence whether or not the condition can or will be met. An example of a permitted condition is that the bidder receives bank funding. The bidder may, however, only withdraw the offer if the satisfaction of the financing condition is deemed to be of vital importance for the acquisition. The Swedish Securities Counsel



(Aktiemarknadsnämnden) has final authority on whether or not any condition complies with accepted market practices.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Debt providers will have priority over equity holders. However, any unsecured debt holders will rank below any debt holders holding security through a lien. Unsecured debt holders will also rank below any creditors holding specific or general priority rights. Claims that have no priority will rank *pari passu*, unless explicitly subordinated.

The order of creditors' priority rights in a debtor's bankruptcy mainly follows from the Swedish Priority Rights Act (*förmånsrättslagen*) (**PRA**).

The PRA divides priority rights into specific priority rights and general priority rights. Specific priority rights are rights related to certain assets and take priority over the general priority rights. The general priority rights are rights to the combined assets of the debtor, including the surplus of assets encumbered by specific priority rights. General priority rights can only be invoked in a debtor's bankruptcy, whereas specific priority rights can also be invoked in respect of the execution of the debtor's assets outside bankruptcy.

Specific priority rights

Specific priority rights rank in accordance with the order of the following paragraphs of the PRA, as set out below:

- (a) covered bonds issued under the Covered Bonds Act (*lagen om utgivning av säkerställda obligationer*);
- (b) legal liens over ships, ship buildings, and aircrafts and spare parts for aircrafts;

- (c) pledges of specific items and rights to retain possession of certain property as security for debts (possessory liens);
- (d) security interests in registered rights, such as securities registered under the Act on Accountkeeping of Financial Instruments (*lagen om kontoföring av finansiella instrument*);
- (e) security interests based on mortgages granted over ships, ship buildings aircrafts or aircraft spare parts;
- (f) registered advances for boat constructions;
- (g) certain insurance policy claims;
- (h) chattel mortgages;
- (i) liens in real property (legal liens and mortgages);
- (j) liens in site-leasehold interests in land (legal liens, claims for tenancy charges due under a lease and mortgages in site-leasehold interests in land); and
- (k) executed property.

General priority rights

A general priority right is not a right to the value of a specific asset but is instead a priority right in all assets belonging to the debtor. The general priority rights apply not only to the bankruptcy estate's cash balance or bank deposits, but also to a potential surplus that might occur once the creditors with specific priority rights have taken their share from that specific property. General priority rights can, unlike specific priority rights, only be invoked in bankruptcy.

Additionally the general priority rights rank in accordance with the order of the paragraphs of the PRA.



Examples of general priority rights are:

- (a) creditor's costs incurred in having the debtor placed into bankruptcy or insolvent liquidation;
- (b) fees and reimbursements for the company administrator under the Company Reorganization Act (*lagen om företagsrekonstruktion*);
- (c) other claims based on agreements entered into by the debtor during a company reorganization (with the administrators consent);
- (d) auditors' costs; and
- (e) employees' claims for wages or other compensation arising from the employment.
- 8. Is interest on debt incurred to acquire a company in Sweden deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Since 2009, interest on intra-group loans for the acquisition of shares in an affiliate (**Main Rule**) has not been deductible in Sweden unless the recipient of the interest income was subject to tax at 10% or higher on the interest income (**Exception 1**) or if the loan was motivated by business reasons (**Exception 2**). This position changed in 2013 as follows:

- (a) the Main Rule now extends to all intra-group loans;
- (b) even if the requirements of Exception 1 are *prima facie* met by the taxpayer, they may nevertheless be considered not met if the Tax Agency is able to show that entering into the debt facility has been mainly motivated by seeking to gain a substantial tax benefit for the group; and
- (c) the business motive test in Exception 2 only applies to recipients domiciled within the EEA, or, under certain circumstances, in a

country with which Sweden has entered into a double taxation treaty.

The words now included in Exception 1 "mainly motivated by a substantial tax benefit for the group" are understood to cover the same general business motive test criteria as the "business reason test" in Exception 2.

If the lender has received an equivalent contribution or distributes its receivable to another group company, the loan would not be considered be to be motivated by business reasons. Tax reasons/benefits do not qualify.

Some of the relevant factors are:

- (a) whether genuine business activities are being conducted in the jurisdiction of the recipient (such as sufficient resources in place at the level of the local entity, including staff and business premises);
- (b) the amount of interest compared to the interest paid on other loans payable in other jurisdictions with higher taxation;
- (c) whether the recipient is neither taxed for interest income nor dividend income; and
- (d) whether the interest can be distributed further up the chain giving a right to deduction.

Also, it is said that an overall assessment of the case at hand will have to be made in relation to the "mainly motivated by a substantial tax benefit for the group" requirement in Exception 1. Passing on loans through the ownership chain that appears to be unnecessary if not for the tax benefit is mentioned, as well as whether the group habitually incorporates new entities for the sole purposes of holding receivables.



It is stressed that the examples given are not an exhaustive list of relevant factors and that the assessment of the tax benefit will be made at group level.

The rules in their current form only restrict deductibility of interest payments abroad to affiliated companies. Intra-group interest payments within Sweden are generally deductible.

Recently, a legislative committee publicized its proposal for new legislation relating to the intra-group interest deduction restriction rules. The proposal consists of two main alternatives for reorganizing the corporate income taxation system in Sweden. In both alternatives, the currently applicable interest deduction restriction rules will be abolished. The proposal is currently being reviewed by a number of remittal bodies such as governmental and local authorities, large Swedish enterprises and concerned industry organizations. The continued legislative procedure will be affected by the feedback from the remittal bodies. The continued legislative procedure will be affected by the feedback from the remittal bodies as well as the fact that the new government, which was elected on 14 September 2014, may alter the direction of the reform.

Sweden currently has no thin capitalization rules.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Sweden?

The PRA is mandatory legislation, which means that the parties cannot contractually create a different priority arrangement from that which is effected by the legislation. A credit agreement that states that the creditor, in the event of bankruptcy, is given priority over other creditors has no legal effect and the creditor will only enjoy an unprioritized claim against the debtor. However, contractual subordination is common in the context of major financings. The same principle applies to negative pledge clauses that are disregarded in the event of bankruptcy. The creditors are contractually bound by a

subordination contract *vis-à-vis* each other and the contractual terms will be honored by a receiver in the event of insolvency proceedings.

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Switzerland

 Is there any prohibition on a company incorporated in Switzerland providing financial assistance in connection with the acquisition of shares in such company or its parent company (either direct or ultimate)?

Although Swiss corporate law does not have any explicit rules on financial assistance, there are several provisions protecting the nominal capital as well as the reserves of a corporation. Therefore, a corporation incorporated in Switzerland may not make payments to its parent company unless that payment is made:

- (a) as a formal dividend;
- (b) in the course of a formal reduction of the company's nominal capital; or
- (c) on the basis of an arm's length contract.

Based on the current legal doctrine, payments to a sister company are subject to these same provisions as payments to a parent company. Payments to a subsidiary are, as a rule, not subject to restrictions. However, exceptions are possible under certain circumstances, for instance, if the subsidiary is not a wholly-owned subsidiary of the relevant corporation.

Furthermore, the granting of a security interest or a guarantee to a third party (e.g., a lender in relation to an acquisition credit facility agreement) for obligations of a parent or a sister company (**Upstream or Cross-stream Security**), as well as other acts having a similar effect (such as an indemnity or the waiving of rights for the benefit of a parent or a sister company), are subject to the same principles as an actual payment. In practice, this means that "financial assistance", or rather the provision by the target company of a security for financial indebtedness of the direct or indirect parent company (shareholder of

the target company) or a sister company, is limited to the amount that the target company could freely distribute to its shareholders as a dividend at the time payment is demanded.

Swiss law does not provide for any "whitewash" procedures or similar measures to avoid or mitigate the consequences of an Upstream or Cross-stream Security.

For an Upstream or Cross-stream Security to be valid (for the limited amount outlined above), the following steps need to be taken in accordance with standard market practice:

- (a) (re-)drafting of the articles of association of the Swiss entity so that they explicitly permit upstream and cross-stream undertakings;
- (b) proper approval of the transaction document providing for an Upstream or Cross-stream Security not only by the board of directors but also by the shareholders of the relevant corporation; and
- (c) insertion of limitation language into the relevant transaction document that provides for the limitation of the security interest or guarantee.
- 2. What are the implications under the corporate benefit laws of Switzerland for a company providing financial assistance?

If the provision of "financial assistance" is not made within the scope of a permissible payment to a parent company (see the answer to question 1), the relevant contractual undertaking may not be binding on the corporation due to a deemed lack of capacity of the individuals entering into the relevant agreement on behalf of the company. Therefore any payment made under a guarantee or a suretyship or the proceeds from the realization of a security interest may be reclaimable.



3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Types of security

The most commonly used forms of security interests over shares and assets are the right of pledge or the security transfer or, in the case of bank accounts and receivables, the security assignment. Fixed charges or floating charges are not known under Swiss law. Generally, under Swiss law, no security over movable assets can be created by way of registration in a public register (except for a small number of assets, such as ships or aircrafts).

Security interests in real estate are usually created by way of a pledge or security transfer of mortgage certificates

Technical requirements

The technical requirements for the creation and perfection of a security interest depend on the form of the security interest and on the type of asset provided as collateral.

As a general rule, the creation of a security interest over movable assets requires possession of those assets to pass from the security provider to the secured parties or to a third party who hold those assets for the relevant secured parties. In principle, no notarization, registration, governmental approval or the like is required for the creation and perfection of a security interest in movable assets. Exceptions exist, as stated above, for security interests to be created in relation to certain specific assets such as ships and aircrafts. The creation of a security interest in those assets requires registration in the relevant register.

For security over real estate, while the pledge or the security transfer of mortgage certificates as such does not require any notarization or registration, a notarization and registration in the land register is required for the creation (and the increase in the nominal value) of mortgage certificates. Although, as a general rule, notification is not required under Swiss law to create a security interest, notification is required to prevent third parties (such as third party debtors in case of an assignment of receivables or the pledge of bank accounts) from being able to validly discharge their obligations by making payment to the security provider.

Tax

There is no tax payable on the grant of a security interest, guarantee or a suretyship under Swiss law except for taxes payable in certain cantons for the creation of mortgages. The fees for notarization and registration (where required) vary from canton to canton. Typically, the value of the mortgage to be created serves as the basis for the calculation

4. How long, following acquisition of a foreign target company, would it usually take in Switzerland for a Swiss subsidiary of that foreign target company to grant a guarantee/security?

There are no specific waiting periods that must be observed before granting a guarantee or a security interest. However, the guarantee or security interest could be an Upstream or Cross-stream Security in which case the restrictions set out in the answer to question 1 apply.

5. Are there any restrictions on foreign banks lending to companies in Switzerland? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

Except for consumer credits where special rules apply, lending by foreign banks into Switzerland on a strict cross-border basis does currently not require any license under Swiss banking laws and is not subject to the supervision of the Swiss Financial Market Supervisory



Authority (**FINMA**). However, certain restrictions may become applicable where security is taken over real estate in Switzerland that is not used for commercial purposes.

Cross-border banking into Switzerland is likely to become subject to more restrictive regulations once the contemplated new law on financial services is enacted. This is not expected to occur, however, before late 2015 or the beginning of 2016.

Withholding tax

Under Swiss domestic tax laws, there is no withholding tax to be deducted by a Swiss obligor on interest payments to be made under a credit facility agreement if the so-called "Swiss non-bank rules" are complied with. These rules provide that:

- (i) the number of finance parties holding a participation / subparticipation in the credit facility that do not qualify as banks in their country of incorporation must not exceed ten (10 non-bank rule); and
- (ii) the total number of direct or indirect financial creditors of the Swiss obligor that do not qualify as banks in their country of incorporation must not exceed twenty (20 non-bank rule).

A breach of the Swiss non-bank rules may trigger the application of Swiss withholding tax, currently calculated at a rate of 35 %. However, if there is an applicable double taxation treaty, the withholding tax may be recoverable by a lender in full or in part.

In addition, interest payments to foreign banks in respect of credits that are secured by mortgages encumbering real estate in Switzerland are in principle subject to a source tax. However, the source tax will, depending on the applicable double taxation treaty, if any, either not be deducted at all, only be deducted at a reduced rate or the amount of the tax will be fully or partially recoverable.

6. If a takeover bid, which relies on bank debt, is made for a public listed company in Switzerland, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Under Swiss law, any takeover offer for a public listed company requires, among other things, the publication of an offer prospectus. According to art. 20 para. 1 of the Swiss Takeover Ordinance, the offer prospectus must contain, among other things:

- (a) the essential details of the financing of the public takeover offer; and
- (b) a confirmation from the auditor that the offeror has taken the necessary measures to ensure that the required funds are available on the settlement date.
- 7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Under Swiss law, equity holders may only participate in the liquidation proceeds after all debt holders have been satisfied in full.

Debt holders' claims are satisfied in a specific order. Firstly, secured claims are satisfied directly out of the net proceeds resulting from the enforcement in relation to the relevant collateral. Secondly, debts incurred by the trustee in bankruptcy for the account of the bankruptcy estate or during a debt moratorium (for restructuring purposes) with the administrator's consent are paid. Thirdly, unsecured claims are satisfied out of the proceeds of the remainder of the bankruptcy estate.

There are three classes of unsecured claims. The first class consists of, among others, certain claims of employees as well as claims of pension funds. The second class consists of claims relating to contributions to certain social insurances. The third class is all other



unsecured claims. They will only be satisfied after all privileged claims have been satisfied in full.

8. Is interest on debt incurred to acquire a company in Switzerland deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

As a general rule, interest on unrelated debt (i.e. bank debt) is fully tax-deductible for Swiss corporate income tax purposes. However, as it is not possible to consolidate the accounts of companies in Switzerland for tax purposes (except for VAT purposes), the purchaser (if it is a Swiss company) may only deduct interest on debt incurred to finance the acquisition from its own earnings and not from the earnings of the acquired company. Furthermore, if the purchaser does not have ordinarily taxable income (e.g., a holding company benefitting from participation relief on dividend payments), the deduction of financing costs is not effective from a tax point of view.

By contrast, for tax purposes, the deduction of interest payments on loans from related parties may be limited by the application of the Swiss thin capitalization rules. According to regulations issued by the Federal Tax Administration, there is a maximum borrowing ratio prescribed for each class of assets. For example, cash/bank accounts can be leveraged by up to 100% of their value, short-term assets by up to 85% of their value, intellectual property by up to 70% of its value and participations by up to 70% of their value. The aggregate amount of borrowings calculated by applying those borrowing ratios basically corresponds to the maximum aggregate amount of debt which a Swiss company is allowed to have *vis-à-vis* related parties to remain compliant with the limits permitted by the Federal Tax Administration. When calculating the maximum leverage, the relevant assets may be valued at their fair market value.

If the debts on the balance sheet exceed the limits allowed by the Federal Tax Administration, the excess portion of the debt (from related parties) is considered hidden equity and interest paid on the excessive portion of the debt might be disallowed as a deductible expense.

The arm's length principle should be respected in any case where the lender and the borrower are related parties (affiliated parties) for Swiss tax purposes. In this context it should be mentioned that the Federal Tax Administration publish safe haven interest rates on an annual basis

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Switzerland?

Subordination agreements under art. 725 section 2 of the Swiss Code of Obligations, which provide for a subordination by one or several creditors for the benefit of all other creditors, should be fully honored by a liquidator and a bankruptcy trustee as that subordination is shown in the financial accounts. In the context of an acquisition finance, however, parties usually enter into bilateral subordination agreements (which are not based on art. 725 section 2 of the Swiss Code of Obligations) (*Nachrangvereinbarung*). These bilateral subordination agreements are often concluded between a shareholder granting a shareholder loan to the borrower and the senior lenders granting the acquisition credit facility to that borrower. Those bilateral subordination agreements are only for the benefit of one creditor or a group of creditors (typically the senior lenders in an acquisition finance transaction). As those subordination agreements are (unlike the ones under art. 725 section 2 of the Swiss Code of Obligations) not reflected in the financial accounts, there is a risk for the senior lenders (if they are the beneficiaries of a bilateral subordination agreement) that the subordination will not be honored by a liquidator or bankruptcy trustee.

Therefore, the subordinated creditor (such as a shareholder having granted a shareholder loan to the acquiring borrower) is often required by the senior lenders in the bilateral subordination agreement (*Nachrangvereinbarung*) to assign its claims under the subordinated debt (e.g., under the shareholder loan) to the first ranking creditors



(e.g., the senior lenders under the acquisition credit facility) to improve the position of the first ranking creditors in a liquidation and in particular in a bankruptcy of the relevant debtor (i.e., typically the borrower under the acquisition credit facility).

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Taiwan

1. Is there any prohibition on a company incorporated in Taiwan providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Regulatory restrictions on a company providing financial assistance vary, depending on the type of financial assistance. There are two relevant scenarios which we be analyze and discuss below.

Providing a loan to the acquirer

Under Article 15 of the Taiwan Company Law (Company Law) and the Regulations Governing Loaning of Funds and Making of Endorsements/Guarantees by Public Companies (Lending and Guarantee Regulations), a company is prohibited from lending to any of its shareholders or any other person, except in the following circumstances:

- (a) where an inter-company or inter-firm business transaction calls for the lending arrangement; or
- (b) where an inter-company or inter-firm short-term financing facility (not more than one year) is necessary.

The borrower should be a "company." A company is prohibited from lending money to a natural person.

The amount of loans under exception (a) must be equivalent to the amount of the inter-company transaction (such as the supply, sale or distribution) between the lending company and the borrower. The amount of the short-term financing facility under exception (b) must not exceed 40% of the net worth of the lending company. The responsible persons of a lending company (such as the directors, supervisors and managers) who violate these regulatory restrictions will be liable, jointly and severally, with the borrower, for repayment



of the loan and any damage suffered by the lending company as a result of any violations.

There is no further provision or government interpretation that clarifies the above two exceptions.

However, it is unlikely that the provision of a loan by a company to the acquirer, which does not have other business transactions with the lending company, would be deemed to fall within exception (a). The short-term financing between the acquirer and the lending company is limited to a term of not more than one year and subject to the 40% net worth restriction.

Providing a guarantee or collateral to secure the obligations of the acquirer

Under Article 16 of the Company Law, a company shall not act as a guarantor of any nature, unless otherwise permitted by any other law or by its articles of incorporation.

Under Article 5 of the Lending and Guarantee Regulations, a public company may make endorsements/guarantees or provide collateral to secure the obligation of the following companies:

- (a) a company with which it does business;
- (b) a company in which the public company directly and indirectly holds more than 50% of the voting shares; and
- (c) a company that directly and indirectly holds more than 50% of the voting shares in the public company.

Companies in which the public company holds, directly or indirectly, 90% of the voting shares may make endorsements/guarantees for each other, if the amount of the endorsements/guarantees does not exceed 10% of the net value of the public company. Companies in which the public company holds 100% of the voting shares are allowed to make

endorsements or guarantees for each other without being subject to this 10% restriction.

Where a public company fulfills its contractual obligations by providing mutual endorsements/guarantees for another company in the same industry for the purposes of undertaking a construction project, or where shareholders make endorsements or guarantees for their jointly- invested company in proportion to their shareholding percentages, those endorsements or guarantees may be made free of the restrictions set out under Article 5 of the Lending and Guarantee Regulations.

Therefore, generally, a private company may provide a guarantee or collateral to secure the obligations of the acquirer, if the articles of incorporation of that private company allow it to do so; a public company may provide a guarantee or collateral for the obligations of the acquirer which owns 50% of its voting shares.

Some companies state in their articles of incorporation or internal rules relating to guarantees and endorsements a maximum amount of guarantee and endorsement that the company may provide to others. If the accumulated amount of guarantees and endorsements exceeds that maximum amount, a shareholders' meeting must be convened to amend the articles of incorporation and/or the internal rules.

2. What are the implications under the corporate benefit laws of Taiwan for a company providing financial assistance?

In Taiwan, directors and managers of a company have a duty to act in good faith for the benefit of the company as a whole and for a proper purpose. This duty is prescribed under the Civil Code as well as under Article 23 of the Company Law.

As this duty also applies to dealings between companies in a corporate group, when considering providing financial assistance for the acquisition of a company's shares, the directors and managers in



charge of providing that financial assistance must continue to act in good faith for the benefit of that company.

As explained in the answer to question 1, if the exceptions to the Lending and Guarantee Regulations do not apply, a company is not permitted to provide a loan to a party that intends to acquire shares in that company or in its parent company. Any director acting in violation of these regulatory restrictions will be liable, jointly and severally, with the borrower, for repayment of the loan and any damage suffered by the lending company because of the loan.

With regard to other types of financial assistance, it is essential that the director and manager in charge of providing the financial assistance comply with their fiduciary duties and obligation to act in good faith.

As it may be difficult to determine whether a director or manager acts for the benefit of the company, it is generally recommended that the company pass a board resolution or hold a shareholders' meeting, as the case may be, to approve the provision of any financial assistance.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most typical types of security interests taken in acquisition finance transactions over property in Taiwan include:

- (a) pledges created over shares;
- (b) mortgages created over real property or certain movable property such as machinery and equipment); and
- (c) pledges and other liens created over other assets.

Certain liens over the assets of a company must be registered with the competent authorities or registration agent. Failure to register, if required, may make the lien invalid or will affect the enforceability and priority of that lien.

In relation to the shares of a company, which is not listed on the Taiwan Stock Exchange or the GreTai Securities Market (the overthe-counter listing authority), the share pledge must be registered with the company and the share certificates must be endorsed and delivered to the pledgee. In relation to the shares of a listed or an OTC company, the pledge must be registered with the Taiwan Depository and Clearing Corporation, which is a custodian of listed and OTC stocks. Without registration, the share pledge will not be effective against the company or third parties.

Mortgages created over real property must be registered with the relevant government land office.

For certificates of time deposits, the certificates must be delivered to the pledgee and the pledge must be notified to the deposit bank. No registration is required.

Generally, there is no stamp duty levied on security documents, such as a pledge agreement or mortgage agreement. The registration fees for collateral other than real property are quite minimal - between USD0 and USD40. However, the registration fee for real property is 0.1% of the mortgage amount, which can be significant. These registration fees are generally paid by the mortgagor or the borrower.

4. How long, following acquisition of a foreign target company, would it usually take in Taiwan for a Taiwanese subsidiary of the foreign target company to grant a guarantee/ security?

The time period for a Taiwanese subsidiary of a foreign target to grant a guarantee/security after acquisition of its foreign parent company will depend on:



- (a) the group structure of the target company;
- (b) the number of Taiwanese subsidiary companies involved;
- (c) whether the Taiwanese parent company or the Taiwan subsidiary is a public company or not; and
- (d) whether the articles of incorporation provide any specific requirements for providing the guarantee/security.

If a board resolution is required, the relevant board of directors' meeting may be held on the same day the acquisition is completed. Registration of the pledge or mortgage may take one to three days, depending on the type of security.

If approval at a shareholders' meeting is required, the approval may take from 15 days to 75 days, depending on whether the company is a listed, public or private company, and whether the company will convene a general shareholders' meeting or an extraordinary shareholders' meeting.

5. Are there any restrictions on foreign banks lending to companies in Taiwan? Are interest payments to foreign banks typically subject to withholding tax?

Banking business in Taiwan

Banking services are highly regulated and focused on protecting customers. Only authorized financial institutions may provide banking services, and they are subject to close monitoring by the regulatory authorities, such as the Financial Supervisory Commission (FSC) and the Central Bank of Republic of China (Taiwan).

Restrictions on foreign banks in Taiwan

In general, in Taiwan, a bank may not engage in a marketing activity if it does not have a banking license or an FSC approval. If a foreign bank wishes to conduct banking business in Taiwan, it must first be

recognized by the Taiwan government and has to establish a branch in Taiwan in accordance with the Company Law and the Banking Act of the Republic of China. The rules for the establishment and operation of foreign banks prescribed by the FSC are the Regulations Governing Offshore Bank Branches and Representative Offices.

Restrictions on foreign banks lending from abroad

If a foreign bank grants a loan directly from abroad but does not physically conduct any banking business, including marketing and liaison services, in Taiwan, the bank is not required to obtain approval from the FSC or establish a branch or liaison office in Taiwan.

Interest payments and withholding tax

Interest payments to a foreign bank without a branch office in Taiwan are subject to 20% withholding tax imposed by the Taiwan tax authorities. However, on September 14, 2013, Taiwan entered into double taxation agreements with 25 countries and 22 of them offer a preferential withholding rate of 10% that applies to interest income. The major countries that have entered into double taxation agreements with Taiwan include Australia, Belgium, Denmark, France, Germany, Malaysia, New Zealand, the Netherlands, Sweden, Switzerland and UK.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Taiwan, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Tender offer regulation

The Regulations Governing Tender Offers and the Regulations Governing Mandatory Disclosure in Tender Offer Prospectus (together, **Tender Offer Regulations**) were made by the FSC under Article 43-1 of the Securities and Exchange Act of Taiwan. The Tender Offer Regulations require certain information relating to an offeror's funding to be disclosed in the tender offer prospectus, which



is to be filed with the FSC and distributed to the target company's shareholders.

That information includes, among other things, the source of funding (e.g., the offeror's own funds and/or financing from banks). According to the Tender Offer Regulations, if any financing will be used for the tender offer:

- (a) the tender offer prospectus must provide a detailed financing and repayment plan, including the source of the borrowed funds and the primary borrower(s); and
- (b) if the target company's assets will be used as collateral for the loans granted to the offeror, the prospectus must disclose the terms of that security and the impact on the financial condition and business of the target company.

Condition to close tender offer

According to the Tender Offer Regulations, the conditions to close the tender offer are limited to the minimum tender condition (i.e., the tender offer will not close until the minimum number of the target's shares have been tendered) and any regulatory approval conditions (e.g., antitrust clearance and foreign investment approval). In other words, the regulators do not accept the obtaining of sufficient financing as one of the offeror's conditions to close a tender offer. If the offeror is unable to obtain sufficient financing and fails to close the tender offer, it will be held liable for the losses suffered by the target's shareholders who have accepted the offer.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

The regulatory regime for a company's bankruptcy in Taiwan is set out in two laws, namely, the Company Law and the Bankruptcy Law.

The Reorganization Chapter of the Company Law provides a regulatory regime similar to the regime in Chapter 11 of the US Bankruptcy Code and the Bankruptcy Law provides a regulatory regime similar to the regime in Chapter 7 of the US Bankruptcy Code.

Liquidation

If a company initiates a standard liquidation, all debts and claims reported to the liquidators within three months after public announcement by the liquidators may be admitted as "Liquidation Claims." During this reporting period, Article 328 of the Company Law provides that the liquidating company may repay the secured creditors (such as a real property mortgagee or a pledgee of the company's movable assets) after obtaining prior approval from the court

If the property of the company is clearly insufficient to meet all debts and claims, the court will order a special liquidation. Article 340 of the Company Law provides that under a special liquidation proceeding, all the debts and claims of the liquidating company will be paid proportionately. However, Article 340 of the Company Law further provides that secured creditors and creditors with preferential repayment rights (e.g., maritime lien holders) are not subject to the special liquidation and are entitled to be repaid in advance.

Whether or not a company is under a normal or special liquidation proceeding, debt holders are given priority over equity holders by law.

Reorganization

The purpose of company reorganization is to rehabilitate an insolvent company by continuing its business and adjusting the rights and interests of its shareholders, creditors and other interested parties. If the court approves the reorganization, all claims that existed prior to the court's decree announcing the commencement of reorganization are claims that may be reported to the reorganization supervisors during the reorganization proceedings and will be admitted as "Reorganization Claims." However, if the claims did not exist before



the commencement of reorganization or were not reported to the reorganization supervisors during the proceedings, those claims will continue to be legally effective and may be claimed after the reorganization proceedings are completed.

There are different priorities for payment or distribution among the "Reorganization Claims". Generally, priority is given firstly to "Preferential Claims," secondly to "Secured Claims" and then to "Unsecured Claims," as set out below.

Preferential Claims

"Preferential Claims" means those claims given priority by law, such as claims for taxes, claims arising out of preserving the company's business and operation, and expenses arising out of the reorganization procedure.

Secured Claims

"Secured Claims" includes claims secured by mortgage(s), pledge(s), lien(s), etc.

Unsecured Claims

All other claims are "Unsecured Claims."

Holders of "Unsecured Claims" may not recover their claims unless the Preferential Claims and the Secured Claims are first satisfied in the reorganization proceedings. Holders of "Preferential Claims", "Secured Claims", "Unsecured Claims" and shareholders of the debtor company are collectively referred to as the "Relevant Parties" (individually the Relevant Party). Each Relevant Party constitutes a separate class of claimants under the reorganization proceedings.

If the company's net worth is negative, the shareholders as a class will have no voting rights.

8. Is interest on debt incurred to acquire a company in Taiwan deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Interest payment

Interest payments on debt used to fund an acquisition are taxdeductible in Taiwan, subject to the thin capitalization rules explained below

Thin capitalization rules

Effective from January 1, 2011, the thin capitalization rules under Article 43-2 of the Taiwan Income Tax Act apply and any excessive interest paid to a related party will not be allowed as a tax deduction. The current cap on related party loans is set at three to one (3:1), meaning an inter-company loan between related parties cannot be more than three times the registered working capital or the excessive interest paid to the related party will not be tax-deductible.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Taiwan?

Under Taiwanese law, the concept of freedom of contract is recognized unless any provision of a contract is prohibited by any mandatory law. Therefore, contractual subordination will be generally honored by a liquidator or bankruptcy trustee in Taiwan.

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Thailand

1. Is there any prohibition on a company incorporated in Thailand providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

In Thailand, there is no specific regulation prohibiting the extension of financial assistance to a person who is acquiring a company.

However, under Thai corporate law (Section 1144 of the Civil and Commercial Code (regulating private limited companies) (Civil and Commercial Code) and Section 85 of the Public Company Act (regulating public limited companies) (Public Company Act), directors must conduct the business of the company in accordance with the articles of association, the objectives of the company, and the resolutions of the shareholders in good faith, and in the best interests of the company. Therefore, a Thai company may enter into any transaction to provide financial assistance only if that transaction:

- (a) is within the objectives of that Thai company;
- (b) complies with the articles of association of that Thai company; and
- (c) is not contravened by any resolution of the shareholders of that Thai company.

In practice, to ensure that the transaction is binding on the Thai company and the transaction will not be challenged, the directors will normally request the shareholders' approval or ratification of the transaction.

If the financial assistance is also provided by a public limited company in certain circumstances, particular additional requirements of the Public Company Act apply.



If the financial assistance is provided by way of "transfer of whole or important parts of the business company" to the acquirer, Section 107 of the Public Company Act requires that the transaction be approved by the resolution of shareholders having votes of not less than three quarters of the total number of votes of shareholders attending the meeting and having the right to vote.

If the financial assistance is provided by way of payment of dividends, that payment of dividends must be approved by the shareholders of the company with a majority vote and those dividends must be paid only out of company profits. If the company still has accumulated loss, then no dividends may be distributed. However, if allowed under the articles of association of the company, the board of directors may pay interim dividends to the shareholders from time to time if the board believes the profit of the company justifies the payment. In that case, after the dividends have been paid, the dividend payment must be reported to the shareholders at the next shareholders' meeting.

2. What are the implications under the corporate benefit laws of Thailand for a company providing financial assistance?

Requirements

Thailand recognizes the concept of "corporate benefit" in both the Civil and Commercial Code and the Public Company Act.

The Civil and Commercial Code prescribes that the directors must, in their conduct of the business of the company, apply the diligence of a careful businessman. In particular, the directors are jointly responsible for:

- (a) the subscription for shares being actually made by the shareholders;
- (b) the existence and regular keeping of books and documents as prescribed by law;

- (c) the proper distribution of the dividend or interest as prescribed by law; and
- (d) the proper enforcement of the resolutions of the general meetings.

Potential conflict of interest

A director must not, however, without the consent of a general meeting of shareholders, undertake commercial transactions of the same nature as, and competing with those of, the company, either on his/her own account or that of a third person, nor may he/she be a partner with unlimited liability in another commercial concern carrying on a business of the same nature as, and competing with, that of the company. This also applies to persons representing the directors

Claims against directors

Any claims against the directors for compensation for damages caused by the directors in relation to the company can be brought by the company or, if the company refuses to act, by any of its shareholders. However, after the acts of a director have been approved at a general meeting, the director is no longer liable, in relation to those acts, to the company or to the shareholders who approved them. Shareholders who did not approve the relevant acts cannot bring an action later than six months after the date of the general meeting at which those acts were approved.

As mentioned in the answer to question 1 above, Section 85 of the Public Company Act prescribes that in conducting the business of the company, a director of the company must act in accordance with law, the objectives of the company, the articles of association of the company, and the resolution of the shareholders' meeting in good faith and in the company's best interests. If any director does not act as required, the company or the shareholders may act as follows:

(a) if the act or omission of the director causes damage to the company, the company may make a claim for damages against



that director. If the company does not make a claim, shareholders holding not less than 5% of all issued shares of the company may instruct the company to do so by written notification to the company. If the company still fails to act, the relevant shareholders may file the claim themselves on behalf of the company; and

(b) if the act or omission of the directors causes damage to the company, shareholders holding not less than 5% of all issued shares of the company may file an injunction with the court for suspension of that act.

There are two issues to be considered as follows:

- (a) if the act of the director is an *ultra vires* act, i.e., outside the power of the company or prohibited under its articles of association, the relevant act will not be binding on the company and the directors will be solely responsible for that act unless the shareholders have approved or ratified the act.
- (b) if the relevant act of the director is within the power of the company but is not in the best interests of the company, the act will not be void but the company or the shareholders have the right to make a claim for damages against the directors. However, if the act, whether or not beneficial to the company, is approved or ratified by the shareholders of the company, the directors do not have any further liability to the company for that act.

As mentioned in the answer to question 1 above, in Thailand, there is no regulation prohibiting the extension of financial assistance to a person to acquire a company. If the directors of a company authorize the provision of financial assistance for the acquisition of the company's shares and that action is allowed under the memorandum and articles of association of the company or has been approved or ratified by a resolution passed at the shareholders' meeting, that act will be binding on the company without the directors incurring any liability.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

At present, there are only two forms of security interest over assets recognized by Thai law: pledge and mortgage.

In practice, parties often enter into other forms of contract in relation to property (e.g., assignment or option). These contractual "security arrangements" while commonly used, are not recognized as security interests by Thai law (in particular, Thai bankruptcy law).

Pledge

A pledge can be created over movable property by physical delivery of the pledged property to the pledgee. Negotiable instruments (e.g., bill of exchange, promissory note, cheque and negotiable certificate of deposit) can also be pledged under Thai law by way of endorsement.

For the pledge of shares, Thai law requires that the pledgor physically delivers the share certificates representing the pledged shares to the pledgee and records the pledge in the shareholder registry book of the company whose shares are pledged. With respect to listed shares, Thailand Securities Depository Company Limited, the registrar of all listed shares on the Stock Exchange of Thailand, has a procedure in place for the creation of pledges over shares by way of a book-entry system, which does not require the physical delivery of share certificates. It should be noted that the pledge is automatically discharged if the pledged property is returned to the possession of the pledgor.

The pledge agreement is subject to THB1 stamp duty for underlying obligations which the pledge secures and which do not have a specific monetary value. Furthermore, a pledge agreement is subject to THB1



stamp duty per every THB2,000 (approximately USD60)⁵¹ of underlying obligations which the pledge secures. However, a pledge is exempt from stamp duty when the pledge secures obligations under a loan agreement in respect of which stamp duty has been paid.

Mortgage

A mortgage can be created over immovable property. However, the following types of movable property can also be mortgaged if they are registered under the relevant law:

- (a) ships or vessels of not less than 6 tons, and steam launches or motor boats of not less than 5 tons;
- (b) floating houses;
- (c) certain animals that can be used as vehicles; and
- (d) any other movables with regard to which the laws allow for registration (e.g., machinery or cars).

The Civil and Commercial Code provides that a contract of mortgage must be made in writing and must be registered with the relevant authorities. The contract must specify the mortgaged property and must contain, in Thai currency, a statement of a certain sum or a maximum amount that is secured by the mortgage contract.

The official mortgage registration fee will be calculated on the basis of the mortgaged property, for example:

(a) for land and building mortgages, 1% of the mortgage value but not exceeding THB200,000 per mortgagee under each mortgage;

⁵¹ Converted at USD1 = THB 32.9575 according to Average Counter Rates Quoted by Commercial Banks published in the Bank of Thailand Website on 16 January 2014.

- (b) for a machinery mortgage, 0.1% of the mortgage value but not exceeding THB100,000 per mortgage;
- (c) for a condominium mortgage, 1% of the mortgage value for each mortgage; and
- (d) for a vessel mortgage, the registration fee will be based on the size of the vessel but not exceeding THB20,000 per mortgagee under each mortgage.

Assignment of rights

Thai law does not have a concept of security over contractual rights, except for the rights under bills and certain instruments that can be pledged as mentioned above.

Therefore, granting security over rights under a contract will not be regarded as granting a security interest under Thai law (including Thai bankruptcy law). Nevertheless, in practice and if the contract can be assumed to have been entered into by a borrower and counterparty, a security arrangement over the rights under a contract can be made by way of assignment of those rights by the borrower to the lender as collateral. This arrangement is commonly used in Thailand to create a right in favor of the lender where a security interest over the contractual rights is not available under the law as explained above.

4. How long, following acquisition of a foreign target company, would it usually take in Thailand for a Thai subsidiary of that foreign target company to grant a guarantee/ security?

General

The time period for a Thai subsidiary of a foreign target company to grant a guarantee/subsidiary depends on the type of security, whether the Thai subsidiary granting a guarantee/security is a listed company and whether the Thai subsidiary is treated as a foreigner under the Foreign Business Act B.E. 2542(1999), as amended (**FBA**).



The FBA prescribes that foreigners are prohibited from operating the types of businesses prescribed in Schedule 3 of the Act. These include service businesses, unless they are granted a license from the Ministry of Commerce (MOC), i.e., the Foreign Business License (FBL). For the purpose of the FBA, the definition of foreigner includes a person registered in Thailand having half or more of its capital shares held by a person not registered in Thailand.

The MOC has interpreted the FBA in such a way that the issue of a letter of guarantee or granting of security for a loan sought by another company, whether with or without remuneration, is deemed to be conducting a "service business" under the FBA, and therefore requiring an FBL. As such, if the Thai subsidiary falls within the definition of a "foreigner" under the FBA, then it is recommended that the Thai subsidiary obtain the FBL in respect of the granting of the guarantee/security from the MOC before it grants that guarantee/security. Normally it will take 6 to 8 weeks to obtain the FBL.

Connected Transactions

Also, if the Thai subsidiary is a listed company, that Thai listed company is required to comply with procedures as stipulated under the Stock Exchange of Thailand (SET) Notification Re: Disclosure of Information and Acts of Listed Companies Concerning the Connected Transactions (Connected Transaction Rule), on making a decision to enter into a transaction where that transaction is a "connected transaction."

A transaction can be regarded as a "connected transaction" if it is a transaction between a listed company or the listed company's subsidiary and the listed company's connected person(s)(Connected Transaction).

If a listed company or its subsidiary enters into a connected transaction, the listed company is required to comply with the prescribed duties, depending on the value of the transaction. This applies in cases where the transaction pertains to assets or services and the connected transaction includes financial assistance. Timing for the carrying out of the Connected Transaction varies depending on the value of the transaction because the required duties differ depending on the different value thresholds. If the value of the Connected Transaction reaches the highest value threshold where a shareholders' resolution to approve the relevant Connected Transaction is required, it may take up to 45 to 60 days to convene a board of directors' meeting and shareholders' meeting to approve the transaction.

Disclosure to the SET requirements

Under the Connected Transaction Rule, a listed company is required to make different levels of disclosure, depending on the type of transaction to be undertaken by the listed company or its subsidiary. The disclosures required by the SET are as follows:

- (a) Disclosure to the SET;
- (b) Notice to the shareholders' meeting; and
- (c) Notice to the shareholders.

Requirement of approval by the board of directors

If the transaction involves a listed company offering financial assistance to connected persons of less than THB100 million or less than 3% of the net tangible asset value, the listed company is required to seek approval from the board of directors when entering into a Connected Transaction. The listed company must preclude directors who have interests in relation to making the decision to enter into the Connected Transaction from attending the relevant meeting and voting at that meeting. The listed company must also include a resolution containing the relevant information in the Disclosure to the SET.



Requirement of approval by the shareholders

If the transaction involves a listed company offering financial assistance to connected persons of more than THB100 million (approximately USD3,034,210) or more than 3% of the net asset tangible value, whichever is higher, a resolution of the shareholders' meeting approving a decision to enter into a Connected Transaction is required in order to approve the transaction. The resolution must consist of at least three-quarters of the total votes of shareholders attending the meeting and having voting rights, excluding interested shareholders' equity.

In practice, the corporate approval requirement can be obtained by the seller prior to the closing of the acquisition.

5. Are there any restrictions on foreign banks lending to companies in Thailand? Are interest payments to foreign banks typically subject to withholding tax?

Restrictions on foreign banks lending in Thailand

It is not necessary under the laws of Thailand for foreign banks to be licensed or qualified to carry on lending in Thailand unless a foreign bank carries on a commercial banking business in Thailand. Under the Financial Institution Business Act B.E. 2551 (2008), "commercial banking business" means the business of:

- (a) accepting deposits of money subject to withdrawal on demand or at the end of a specified period; and
- (b) employing that money in one or several ways such as:
 - (i) granting of credits;
 - (ii) buying and selling of bills of exchange or any other negotiable instruments; and
 - (iii) buying and selling of foreign exchange.

Interest payments and withholding tax

Withholding tax is payable at the rate of 15% on loan interest, commitment fees, front-end fees, cancellation fees and prepayment fees payable by a Thai resident borrower to a foreign lender that is a foreign company not carrying on business in Thailand or whose permanent establishment is not involved in the relevant lending transaction

The withholding tax will generally be reduced to 10% if a lender is a financial institutions that is a tax resident of a country that has a tax treaty with Thailand. There is no withholding tax on loan interest, commitment fees, front-end fees, cancellation fees and prepayment fees to lenders that are wholly owned by the Government of Japan.

Agency fees

Agency fees payable to agents incorporated for agency services rendered within Thailand are subject to withholding tax at the rate of 3% of the amount paid and may generally be subject to a value-added tax at the rate of 7% of the amount paid.

Agency fees payable to the agent for agency services rendered outside Thailand are generally subject to withholding tax at the rate of 15% of the amount paid. However, if an agent is a tax resident of a country having a tax treaty with Thailand, an exemption applies, if that agent does not have a permanent establishment in Thailand or the agency fees are not attributable to the Thai permanent establishment of that agent. The agency fees are subject to a value-added tax at the rate of 7% of the amount paid.

Restrictions on exchange control

If interest will be paid from a Thai resident borrower to foreign lenders, the purchase and remittance of foreign currency out of Thailand require exchange control approval from a commercial bank operating in Thailand that is an authorized agent of the Bank of Thailand



6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Thailand, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

The Securities and Exchange Act (SEC Act) and SEC Notification No. Tor Jor 12/2554 dated 13 May 2011 Re: Rules, Criteria and Procedures for Business Takeover governing the takeover of business (Takeover Notification) require a person who has acquired shares in a company up to the percentage that is significant to the change of control or management of a company (Trigger Point) to make a tender offer (Tender Offer) and comply with the Tender Offer requirements under the applicable regulations. This is to allow existing shareholders the opportunity to sell their shares on the change of control or business takeover.

The Takeover Notification basically requires an acquirer of shares in the company reaching or exceeding the Trigger Point to make a tender offer for all outstanding shares sold in the business (all 100% of the total shares sold), including other equity-linked securities (e.g., warrants and convertible debentures).

The Takeover Notification does not have a specific requirement that regulates the certainty of the availability of the bank debt that is relied on for making the takeover. However, one of the requirements under the Takeover Notification is that the acquirer must submit the tender offer to the public in accordance with the form prescribed by the Office of the SEC (Form 247-4). Under that form, there is a requirement for the acquirer to state the source of the funds that will be used for making the offer. If those funds come from bank debt, the acquirer must provide the following information:

- (a) the name of the financial institution that will be providing the funds;
- (b) the provision on the cancellation of the funds (if any); and

- (c) if the source of the repayment of the funds is the target company, the acquirer must specify the term of repayment and the method by which the funds for repayment will come from the target company (i.e., dividend from the target company or loan granted from the target company), including the effect that this will have on the target company, e.g., the target company will have to dispose of some of its assets in order to make the dividend payment or to grant the loan to the acquirer, etc.
- 7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

In Thailand, debt holders are given priority over equity holders. In an insolvency situation, only a "creditor" can file a claim for repayment of a debt.

A secured creditor will have rights over the asset that has been granted as security by the debtor before the insolvency.

Among the unsecured creditors, Section 130 of the Bankruptcy Act BE 2483 (1940) (**Bankruptcy Act**) prescribes that the assets will be paid in the following order:

- (a) expenses for the administration of a deceased debtor's estate;
- (b) expenses of the receiver in managing the debt's assets;
- (c) funeral expenses of a deceased debtor proper to his/her status;
- (d) fees for collecting assets in case of an appeal with regard to a claim for payment of debt;
- (e) fees of the petitioning creditor and counsel's fee as the court or the receiver may prescribe;
- (f) taxes which have become due for payment within six months prior to the insolvency and wages; and



(g) other unsecured debts.

If the money is insufficient to pay the debt in any group above in full, the creditors in that group will be paid *pari passu*.

8. Is interest on debt incurred to acquire a company in Thailand deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

Interest payments on debt used to fund an acquisition are generally tax-deductible in Thailand, with some exceptions.

There is no thin capitalization rule under Thai law.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Thailand?

The Bankruptcy Act prescribes the order of distribution of assets among the creditors as already mentioned in the answer to question 7 above. As well as that order of priority, the Bankruptcy Act recognizes contractual subordination. Section 130 of the Act prescribes that "in case where any debt under Section 130(7) (other debts) is required by law or by contract that a creditor shall have the right to receive repayment only after other creditors have received repayment in full, such creditor shall remain entitled to a distribution of the assets in accordance with the rights to which he is entitled pursuant to such law or contract."

Therefore, Thai law does recognize the concept of contractual subordination and it would be honored by a liquidator on bankruptcy.

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Turkey

1. Is there any prohibition on a company incorporated in Turkey providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Financial assistance by joint stock companies

Under Turkish law, financial assistance is considered to be a circumvention of the prohibition on a company acquiring its own shares, and is regulated under Turkish Commercial Code No. 6102 (TCC). Under Article 380 of the TCC, a joint stock company (anonim sirket) in Turkey must not provide an advance, loan or security to third parties to support the acquisition of its own shares or that transaction will be null and void. This applies to a Turkish target company that is a joint stock company.

Financial assistance through provision of advances, loans or securities is prohibited regardless of timing. In other words, the target company cannot provide financial assistance as described above, even after the target's shares are acquired.

Financial assistance by companies that are not joint stock companies

The prohibition against the giving of financial assistance does not apply to other types of companies in Turkey such as limited liability companies, collective companies and commandite companies. Therefore any company in Turkey that is not a joint stock company can provide financial assistance subject to complying with general legal considerations such as capital maintenance.

Parent companies

Financial assistance provided by a Turkish company in connection with the acquisition of its parent company's shares is not specifically regulated under the TCC.

It could be concluded therefore that there is no limitation in relation to a Turkish company providing financial assistance for the acquisition of its parent company's shares.

On the other hand, circumvention of law (i.e., achieving a result that is forbidden by law by using other legal mechanisms), is not permissible under Turkish law. There is no specific reference under the TCC to providing securities, advances, loans and other sorts of financial support to a Turkish company in connection with the acquisition of its parent company's shares. One could argue, however, that a Turkish joint stock company providing financial assistance for this purpose is a circumvention of law and is prohibited. The use of this type of mechanism has not yet been tested in the Turkish courts and it is not possible to foresee whether Turkish courts will interpret this as a circumvention of the law.

The TCC requires the parent to compensate its subsidiary, if the parent forces the subsidiary to provide financial assistance and the subsidiary suffers a loss

Exceptions

There are two exceptions to the prohibition on financial assistance. Firstly, credit and financial institutions (mainly banks) may provide assistance for the acquisition of their own shares. Secondly, a company may provide advances, loans or securities to support the acquisition of its shares by its employees or its subsidiaries' employees as part of their stock options.

Further requirements

Under Turkish corporate governance rules, if the Turkish subsidiary is a public company (i.e. a joint stock company whose shares are publicly traded), it may not grant a security or guarantee in favor of third parties in any circumstances unless that grant of security or guarantee is in the ordinary course of the Turkish subsidiary's business or the relevant third party is consolidated into the financial statements of the public company. If it does grant a security or a



guarantee, the Turkish subsidiary's board must also resolve to approve the transaction, with affirmative votes by the majority of its independent directors.

2. What are the implications under the corporate benefit laws of Turkey for a company providing financial assistance?

In Turkey, directors owe a fiduciary duty to the company while acting on behalf of the company, which they must carry out prudently and diligently. Accordingly, directors are subject to a duty of care, meaning they must carry out the company's business with the caution and care expected from a "cautious merchant."

As a general rule, a company's directors are not personally liable for acts performed on the company's behalf, if the acts comply with applicable laws and the company's articles of association. In other words, a director's liability is based on "fault," defined under Turkish law as willful misconduct or negligence. Therefore, companies' directors and managers are liable to the company, its shareholders and creditors if they violate applicable laws and articles of association.

The directors' duty also applies in relation to transactions between companies in the same corporate group, i.e., a director must continue to act diligently, prudently and in good faith for the benefit of the company of which it is a director even when that company is transacting with another company within its corporate group.

Because financial assistance by a joint stock company is prohibited by law, a director of a joint stock company who approves a financial assistance transaction violating Article 380 of the TCC would be liable for any company losses arising from that transaction.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The types of securities most frequently used in Turkish transactions are:

- (i) share pledges;
- (ii) commercial enterprise pledges;
- (iii) mortgages;
- (iv) assignment of receivables; and
- (v) account pledges.

Commercial enterprise pledge agreements must be executed in Turkish before a Turkish notary where the relevant commercial enterprise is located (registered), and must be registered with the relevant trade registry.

Mortgage agreements must be executed in Turkish and registered with the title registry with which the relevant real property is registered.

Assignment of receivables agreements must be in writing. These agreements and share pledge agreements do not require notarization/registration. They must, however, be executed in Turkish if all parties to the agreement are Turkish individuals/entities.

Any and all agreements and other documents entered into in relation to procuring, repaying and/or securing loans extended by banks in Turkey, foreign credit institutions or international financial organizations are exempt from stamp duty.



4. How long, following acquisition of a foreign target company, would it usually take in Turkey for a Turkish subsidiary of that foreign target company to grant a guarantee/security?

Timing usually depends on the complexity of the financing and security structure, and may also vary for different types of securities and their different localities. If the security agreements require registration, the granting of a guarantee/security may take approximately five to 10 business days assuming that the parties agree with the content and form of the security agreements. The location of the registrars is important regarding the timing, since registrars inexperienced in registering these types of securities may prolong the process.

5. Are there any restrictions on foreign banks lending to companies in Turkey? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

Turkish companies are allowed to accept loan facilities from foreign banks, if these facilities are remitted via banks in Turkey.

The loan must be transferred in and out of Turkey through Turkish banks. The borrower must submit the loan agreement to the relevant Turkish bank and provide certain information in relation to the loan, e.g., term and applicable interest rate.

The Turkish bank facilitating the transfer of moneys in and out of Turkey must notify the Central Bank of Turkey about the loan. This is for information purposes only and does not affect the lenders' repatriation rights or the finance documents' validity.

A foreign bank that solicits its products and services in Turkey may be deemed to be "engaging in banking activities" in Turkey. "Engaging in banking activities" in Turkey requires a banking license that must be obtained from the Banking Regulation and Supervision Agency.

Withholding tax

By the January 1, 2009 Turkish Council of Ministers' decision no. 2009/14593, interest on loans from foreign states, international institutions, foreign banks and companies entitled to provide loans in their resident country is subject to a 0% withholding tax rate.

For loans obtained from non-resident entities not entitled to lend, the withholding tax rate is 10%.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Turkey, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Regulation

The takeover of a Turkish public company is regulated under the Tender Offer Communiqué No. II-26.1 (**TOC**) issued by the Capital Markets Board of Turkey (**CMB**) on January 23, 2014.

Process and payment

Any individual or entity may apply to the CMB to make a tender offer for all or a part of a public company's shares. The tender offer must be launched within six business days of the CMB's approval of the application. The TOC allows the acquirer the right to revoke the tender offer before the offer's launch date.

Payment for the shares acquired via tender offer must be made by the business day following the sale of the shares. The consideration for the shares may be paid by either cash or securities (stocks) or by a combination of both. However, if a seller requests cash payment the offeror must pay the seller in cash. The TOC requires the acquirer to take necessary measures to pay the tender offer price. The CMB, at its discretion, may request that the tender offer price be guaranteed by a Turkish bank or another third party. If the CMB does so, the guarantee agreement must include the following statement:



"In case the offeror has not taken the necessary measures and consequently does not have the necessary financial resources to pay the tender offer price in full, the persons who have accepted the offer may request the compensation of their losses arising from the non-performance of the offer and/or specific performance of the offer from the guarantor."

Bank loans in connection with tender offers

Turkish law does not regulate the certainty of a bank loan's availability in connection with tender offers. However, this risk can be mitigated or addressed through a number of legal mechanisms as follows:

- (a) the offeror has the right to withdraw the tender offer up until the offer's launch (i.e., at most within six business days after the CMB's approval of the tender);
- (b) an escrow mechanism, where the loan proceeds are deposited with the escrow in advance and the escrow can freely make payments to the sellers once the offer is launched, can be used to bypass the lender's discretion over disbursing the loan; and
- (c) the guarantee obligation set out above may also work in favor of the offeror, as it will practically guarantee that the sellers are paid during the offer process.
- 7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

The Enforcement and Bankruptcy Code No. 2004 (**EBC**) provides that all the debtor's enforceable assets will constitute the "bankruptcy pool" when bankruptcy is declared.

Once bankruptcy is declared, under the EBC, the debtor will no longer be able to freely dispose of any of its assets. All secured assets are also included in the bankruptcy pool. Secured assets, however, must be sold by the bankruptcy administration as soon as possible.

The EBC provides for the general principle of *pro rata* distribution, with a number of exceptions.

Secured creditors have priority over unsecured creditors in relation to the sale proceeds of assets subject to a pledge. The sale proceeds of a pledged asset must first be used to cover the taxes and other public debts relating to the pledged asset (e.g., real property tax) and the sale costs, and the remaining amount must be paid to the pledgee up to the amount of its debt. If there is a balance, it must be paid to other creditors. If the sale proceeds do not cover the entire secured amount, the outstanding amount must be covered from the sale proceeds of the other assets in the bankruptcy pool, as set out below. The pledgee will have no priority in relation to that portion of its debt.

A priority order exists in relation to unsecured debts and the portion of secured debts not paid from the proceeds of the sale of secured assets. Public debts (i.e., tax debts, social insurance debts and other debts payable to public authorities), amounts owing to employees (i.e., severance payment and notice compensation), alimony debts and other debts prioritized by special laws all have priority over other debts.

Under Turkish law, creditors have priority over equity holders, as equity holders only receive sale proceeds of assets in the bankruptcy pool after all creditors have been duly paid.

8. Is interest on debt incurred to acquire a company in Turkey deductible from earning for tax purposes? Are there any thin capitalization thresholds?

Any financial expenses relating to the acquisition can be deducted against the profits of the business. However, as debt "push-down" is not permitted under Turkish tax legislation, financial expenses cannot be deducted from the target's profits in a merger process.



Under the Turkish thin capitalization rules, portions of loans that are provided by a related party, which result in a debt-to-equity ratio exceeding 3:1, is deemed to be "thin capital." A related party is defined as a shareholder or other person holding, directly or indirectly, at least 10% of the share capital, voting rights or rights to receive the other party's dividends. 50% of the borrowings from a related party bank or similar credit institution in the business of lending are considered in calculating thin capital. The interest, the difference in exchange rates and other expenses related to this exceeding portion may not be deducted from the tax base nor deemed to be a dividend distribution

If a loan is deemed to be "disguised capital", the financial expenses (interest and foreign exchange losses) are treated as non-deductible expenses in the determination of the corporate income tax base.

If the lending party is not a corporate income taxpayer in Turkey, the interest amount (not FX losses) will be treated as dividend distributed and will be subject to withholding tax.

For loans to be deemed to be disguised capital:

- (a) the loans must be provided, directly or indirectly, by shareholders or related parties of shareholders;
- (b) the loan amount must exceed three times the shareholders' equity of the company at any given time in a fiscal year (and six-times the shareholders' equity if the loan is granted by a bank); or
- (c) the loans must be used in the borrower's enterprise.

For non-residents (including branches), these hidden profit distributions are deemed to be profits remitted to the head office.

Loans that are:

(a) received from third parties under a shareholder or related parties' non-cash guarantee; and

(b) obtained by shareholders or related parties from third-party banks, financial institutions or capital markets, and granted to related parties under the same conditions,

are not included in the thin capitalization calculation.

Interest payments and foreign exchange losses corresponding to thin capital are considered non-deductible expenses in determining the corporate income tax base. Dividend withholding tax at the rate of 15% is charged on the interest paid as at the year-end, unless reduced by a double tax treaty.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Turkey?

Under Turkish law, ranking of creditors is set out under the EBC, and the EBC takes no contractual subordination into account in a bankruptcy process. Therefore, a contractual subordination will not be effective against third parties. When a company enters into a bankruptcy process, the bankruptcy trustee ranks all the company's receivables in the order set out in the answer to question 7. The bankruptcy trustee must repay the debts in this order. A party to a contractual subordination, however, may require the subordinated party to pay it the relevant amount after the subordinated party receives payment from the bankruptcy trustee.

Subordination creates a contractual obligation between the parties, and if there are breaches of this obligation, the senior creditor may seek indemnification from the subordinated creditor.

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United Kingdom

1. Is there any prohibition on a company incorporated in England and Wales providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Under the Companies Act 2006 (Companies Act), a UK public company is prohibited from providing financial assistance (directly or indirectly) for the purposes of the acquisition of shares in that public company, unless certain exceptions apply.

Under English law, financial assistance includes the provision of guarantees and security. The provision of financial assistance postacquisition is also prohibited.

The prohibition operates directly and indirectly. As such, it is unlawful for a UK public subsidiary to give financial assistance for the purpose of an acquisition of shares in its private holding company. Similarly, a private company that is a subsidiary of a public company is prohibited from giving financial assistance for the acquisition of shares in its public holding company. Once again, the prohibition is subject to certain exceptions and extends to the subsidiary company giving any post-acquisition assistance.

However, there are no statutory restrictions on a private company providing financial assistance for the purposes of the acquisition of shares in it or another private company. There are also no statutory restrictions on the giving of financial assistance for the purposes of the acquisition of shares in a sister company.

There are both civil and criminal penalties for breach of the financial assistance provisions. These include the transaction being held to be void and unenforceable (including any security or guarantee given in contravention of the prohibition) and two years imprisonment for officers involved in the breach

2. What are the implications under the corporate benefit laws of England and Wales for a company providing financial assistance?

Under the Companies Act, the directors of a company must act in a way that they consider would promote the success of the company for the benefit of its members as a whole. If a company is providing financial assistance for the acquisition of its own shares, its directors must consider whether they are acting in accordance with their duties, particularly where the transaction may seem to be of little or no corporate benefit to the company.

In some circumstances, it will be relatively easy to demonstrate corporate benefit. This might be the case where a parent is providing guarantees and/or security in respect of the obligations of a whollyowned subsidiary. However, it may be harder to demonstrate corporate benefit where, for example, a subsidiary is providing guarantees and/or security to its parent or to a sister company. In this scenario, it is common to record the reasons for the provision of financial assistance in the board minutes and to ratify the transaction by way of a shareholders' resolution.

The directors of the company providing financial assistance should also, in the ordinary course, consider any capacity, maintenance of capital or insolvency issues and their general duties as directors under the Companies Act.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Types of security

The main types of security under English law are:



- (a) mortgages (equitable and legal);
- (b) charges (fixed and floating);
- (c) pledges; and
- (d) liens.

Mortgages and charges are the most frequently used form of security. It is also possible to grant an assignment of rights by way of security (which is not a separate type of security, but a form of mortgage).

It is common for security to be granted by way of an "omnibus" security agreement, such as a debenture, which will include mortgages, charges and assignments depending on the nature of the security assets (but with the listing of some assets). This is almost always done for transactions involving English companies. Alternatively, separate security agreements can be entered into for each type of asset.

The types of security expected to be used for the following key assets are set out below.

For real estate

Security is usually taken over real estate by way of legal mortgage (or by an assignment for a leasehold interest). Plant and machinery fixed to land are deemed to be part of that land.

For plant and machinery

Security is usually taken over plant and machinery by way of fixed charge.

For receivables

Security is taken over receivables by either an assignment of rights by way of security or a fixed charge.

For shares in companies

For shares in companies incorporated in England, the security taken is usually taken either by way of legal or equitable mortgage over the shares.

For inventory and stock

A floating charge is usually taken over inventory and stock.

Technical requirements

Under the Companies Act, there is a statutory security registration regime for companies incorporated in England. A company that has created a charge, or any person interested in that charge, may, subject to certain exceptions, deliver to Companies House for registration a section 859D statement of particulars of that charge within 21 days of creation. This applies to charges created on or after 6 April 2013. This contrasts with the previous regime where registration only applied to certain categories of charge.

The failure to register a charge within the period allowed renders the charge void against a liquidator, administrator and creditor of the company, meaning that the charge holder will only rank as an unsecured creditor on the debtor's insolvency. Any "creditor of the company" for these purposes has been held by the courts to mean a secured creditor but not an unsecured creditor. It means that any other creditor who, on a later date, registers a charge over the same asset would then take priority over the prior charge holder, even if the subsequent creditor had notice of the prior charge.

If the security is over certain types of asset, there may also be additional registration requirements. For example, security over land must be registered at the Land Registry or the Land Charges Registry. For security over intellectual property rights, the security must be registered at the relevant intellectual property office. There are also specialist registries for ships and aircraft.



Financial Collateral Arrangements (No.2) Regulations 2003 (FCA)

For "financial collateral arrangements" under the FCA, the statutory requirement in the Companies Act to register security has been disapplied. Financial collateral arrangements include fixed security over financial instruments, shares or other forms of "financial collateral" as defined under the FCA. In practice, however, security agreements that create these types of security are usually submitted for registration in any event since the consequences of non-registration are significant.

Taxes

There are no stamp duty, registration taxes or similar documentary taxes or charges required to be paid in England in respect of the execution and delivery of security, except that a fee of GBP 13 is required to be paid to the Companies Registry on registration of each separate piece of security. There are also fees payable to register security over land at the Land Registry or Land Charges department, although these fees are not usually significant.

There are no notarization requirements nor, typically, government approvals required.

4. How long, following acquisition of a foreign target company, would it usually take in England and Wales for a local subsidiary of that foreign target company to grant a guarantee/security?

The target's English incorporated subsidiaries would normally be in a position to grant guarantee and security on, or shortly after, completion.

This may, of course, be dependent on the co-operation of the vendor. However, in theory, all steps (e.g., corporate authorizations (which may be subject to the execution of a sale and purchase agreement), due diligence on the security assets, negotiation of the security

document) required for the English incorporated subsidiary to enter into security or guarantees can be completed on or before completion.

5. Are there any restrictions on foreign banks lending to companies in England and Wales? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

There are no restrictions on foreign banks lending to companies in England and Wales where the foreign bank carries on all of its activities from outside the UK on a cross border basis.

In the making of a loan, English law does not require the lender to be a bank, or to have any particular kind of corporate status. This is due to the fact that English law imposes a licensing obligation on persons who carry out deposit taking activities. Lending is only regulated where the lending is consumer lending as defined in UK law or the lending activities are carried out by an entity such as a licensed bank which is subject to regulatory requirements applicable to lending activities, such as capital obligations.

Tax

As a matter of domestic law, UK companies are required to withhold UK income tax at the current rate of 20% from "yearly interest", unless an exemption applies. The term "yearly interest" is not defined in UK legislation. However, it is generally accepted that if the loan has a term of, or is intended to last for, at least a year, interest payable under that loan should constitute "yearly" interest.

However, the UK benefits from one of the world's largest networks of double taxation agreements covering over 100 countries. This means that, depending on where the foreign bank is resident for tax purposes, the bank may be entitled to receive interest gross or subject to withholding at a reduced rate under the relevant treaty.



In broad terms, UK companies are not required to withhold UK income tax from foreign banks if the bank is lending through its UK branch, i.e. at the time the interest is paid, the bank which is beneficially entitled to the interest is within the charge to UK corporation tax in respect of that interest.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in England and Wales, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

In the UK, takeovers of public companies are regulated by the City Code on Takeovers and Mergers (Takeover Code). The Takeover Code applies to offers for:

- (a) public companies incorporated in and quoted in the UK;
- (b) other public companies incorporated in and deemed to be resident in the UK; and
- (c) certain limited categories of UK incorporated private companies.

The Takeover Code also applies in part to companies incorporated in the UK but whose shares are quoted on a regulated market in a different EEA country or vice versa, where the takeover regulator of the other EEA country will also share jurisdiction. The Takeover Code is issued and administered by the Panel on Takeovers and Mergers.

The concept of "certain funds" in relation to a takeover is dealt with in General Principle 5 and Rules 2.7 and 24.8 of the Takeover Code. A bidder is required to have its financing in place on a "certain funds" basis at the time it announces a "firm intention to make an offer" (assuming the offer is being made wholly or partly in cash) (Rule 2.7) **Announcement**). The Rule 2.7 Announcement contains the full terms and conditions of the offer.

A bidder will effectively be locked in to the offer from the time it makes its Rule 2.7 Announcement. This means that from that time it is only likely to be able to withdraw from the offer if it either fails to achieve the requisite level of support/acceptances from target shareholders or fails to obtain a material competition or other regulatory clearance. The offer cannot be subject to financing or due diligence conditions. Putting in place its financing arrangements will therefore be a key undertaking for the bidder before the Rule 2.7 Announcement (together with its due diligence and putting in place the offer documentation).

The Rule 2.7 Announcement and the subsequent offer document must each include a statement by the bidder's financial adviser (**Cash Confirmation Statement**) that it is satisfied that resources are available to the bidder to satisfy full acceptance of the offer. The financial adviser giving the Cash Confirmation Statement could itself be required to provide the cash consideration if it failed to take all reasonable steps to ensure that the cash was available at the time of the announcement and would continue to be available to pay the consideration to shareholders when required.

In practice, this means that, if the offer is to be funded wholly or partly by drawing down on debt facilities, the ability to draw down on those debt facilities must normally be wholly unconditional or conditional only on the offer succeeding. In addition, however the takeover is to be funded, the bidder's financial adviser is likely to require the bidder to enter into some form of contractual arrangement prior to release of the Rule 2.7 Announcement. This is to satisfy the financial adviser that the financing is available on a "certain funds" basis, so that the financial adviser is then comfortable with giving its public Cash Confirmation Statement. The nature of the contractual arrangement will vary according to the specific circumstances, but will include a letter from the bidder to the financial adviser with various representations and undertakings. It may also include an escrow arrangement.



The concept of "certain funds" is not limited to transactions subject to the Takeover Code (although the way it is implemented may vary in other transactions). The concept has been adopted in offers for quoted companies that are not subject to the Takeover Code as well as in the private acquisition arena, in particular in the context of auction processes where bidders are often keen to demonstrate the certainty of their bid (and the financing of their bid) and the ease with which it can be implemented.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

The Insolvency Act 1986 (**Insolvency Act**) and the Insolvency Rules 1986 (**Insolvency Rules**) create the legal framework for how an insolvency practitioner (**IP**), acting as an administrator or liquidator, must distribute the insolvent estate.

Under the Insolvency Act and the Insolvency Rules, creditors are placed in order of statutory priority for the purpose of distribution. Distribution to each class of creditors is generally made in proportion to the debts due to each creditor within the class (i.e. a *pari passu* distribution).

The order of payment for creditors and shareholders in a corporate insolvency is as set out below in descending order of priority.

Holders of fixed charges and creditors with a proprietary interest in assets

The fixed charge holders are paid from the asset realization covered by the charge (net of the costs of realization). If the asset realizations covered by the charge are insufficient to discharge the debt, the fixed charge holder can claim as an unsecured creditor. The IP's fees will be paid out of whatever remains of proceeds from the realization of the fixed assets although this is agreed with the fixed-charge holder before the fixed charge asset realization. The priority between fixed charge

holders will usually be dictated by the order in which the charges were created.

Expenses of the insolvent estate

These include the proper and necessary disbursements of the IP and his/her remuneration. There are statutory rules setting out the priority of expenses for both administrators and liquidators that must be adhered to.

Preferential creditors

All preferential debts rank equally in the distribution of the available assets. Preferential debts include:

- (a) contributions to occupational and state pension schemes;
- (b) wages and salaries of employees for work done in the four months before the insolvency date, up to a maximum of GBP 800 per person; and
- (c) holiday pay due to any employee whose contract has been terminated, whether that termination takes place before or after the insolvency date.

Holders of floating charges

These will be paid according to the priority of their security.

Floating charges created in the 12 months before the insolvency date are void on the appointment of the IP, except where they secure new lending to the company. The period of 12 months extends to two years in the case of a floating charge made in favor of a creditor "connected" to the company (a director, shadow director or an associate of a director or an associate of the company).



Unsecured creditors

Before distributing monies to the holders of floating charges, an IP must carve out the "prescribed part" for distribution to unsecured creditors. The prescribed part is capped at GBP 600,000 for unsecured creditors. It is calculated as a percentage of the value of the company's property which is subject to floating charges, with 50% of the first GBP 10,000 of net floating charge realizations plus 20% of anything after that.

The IP pays unsecured creditors, on a pari passu basis, from a combination of any remaining asset realizations and the prescribed part.

Statutory interest on claims at the higher of the contract rate or the judgment rate (8%) and non-provable debts

These rank below unsecured creditors but above shareholders.

Shareholders

Any remaining funds belong to the shareholders of the insolvent company. In practice, however, it is very unusual for shareholders to receive anything from an insolvency process.

8. Is interest on debt incurred to acquire a company in England and Wales deductible from earning for tax purposes? Are there any thin capitalization thresholds?

UK resident companies will generally be entitled to claim tax relief for interest expense where that expense is recognized in the company's financial statements, including interest expense incurred by a UK company to finance the acquisition of a UK or a foreign subsidiary.

However, this general rule is subject to a number of exceptions, which are briefly outlined below.

Thin capitalization

The UK's thin capitalization rules are integrated in the UK's transfer pricing rules. Where a UK resident company borrows money from an associated company, the thin capitalization rules aim to determine the amount that the borrowing company could (and would) have borrowed from a third party borrower on the strength of its own balance sheet. The rules then disallow any excess interest expense. The rules also apply to amounts borrowed from an unrelated lender in circumstances where the borrowing is supported by a guarantee (or other credit support) from a related party. The UK does not have a "safe harbor" test by which to determine whether an arrangement is acceptable, as HM Revenue and Customs (HMRC) reviews each loan on its own facts.

Worldwide debt cap rules

The worldwide debt cap (**WDC**) applies to tax accounting periods beginning on or after 1 January 2010, and operates to restrict the aggregate tax deductible interest expense of the UK members of a group of companies by reference to the aggregate external interest expense of the worldwide group of which the UK group forms part.

The WDC rules do not apply where a "gateway test" is satisfied. This test is met where the aggregate net debt of the UK members of a group does not exceed 75% of the global group's worldwide gross debt. If the UK net debt is less than GBP 3 million, it is deemed to be nil.

Where the gateway test is not satisfied, the WDC rules apply and the intercompany financing expenses of the UK members of the group must be assessed by reference to certain fairly complex rules. In broad terms, however, the UK members of the group will suffer a disallowance of interest expense to the extent that the aggregate financing expense of the UK group members exceeds the aggregate financing expense of the worldwide group as a whole. The group is permitted to allocate the disallowances between the group's UK resident members or permanent establishments (subject to a 75%



holding requirement), but excess disallowed deductions may not be carried forward.

A number of exceptions from the WDC apply in relation to certain types of company, groups and transactions, for example, short-term intra-group loans.

Anti-arbitrage rules

The UK enacted rules in 2005 that disallow deductions resulting from certain types of tax arbitrage structure. Broadly, the legislation applies where a company that is subject to UK corporation tax is party to a scheme involving hybrid entities or hybrid instruments and the main purpose, or one of the main purposes of the scheme, is to achieve a "UK tax advantage." Where HMRC notifies a company that is subject to UK corporation tax that the anti-arbitrage rules apply to a particular scheme entered into by the company, UK tax relief for interest expense on loans forming part of the scheme will be denied or certain receipts under the scheme will be subject to UK tax.

"Unallowable purpose" rule

These anti-avoidance rules seek to disallow an interest deduction to the extent that a UK resident company has borrowed an amount for an unallowable purpose. An unallowable purpose exists where the main, or one of the main, purposes of the borrowing is the obtaining of a UK tax advantage and there is no predominant business or other commercial purpose. When the rules apply, the taxpayer will be denied a deduction for interest paid on the unallowable element of the loan (which may be the whole amount). These rules operate as an "overlay" to the thin capitalization rules and will usually only apply in the case of contrived or artificial financing arrangements.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in England and Wales?

In a contractual subordination, the debtor, the junior creditor and (usually) the senior creditor agree that the debtor will not make any

payments in respect of the junior debt until the debtor has paid the senior debt. In some instances, certain payments (e.g., interest payments) to the junior creditor are permitted as long as specified events, such as an event of default, do not occur.

It is also usual for the junior creditor to agree not to pay the debt due to him/her using set-off. Whilst there is nothing preventing the junior creditor from excluding his/her set-off rights in this way before the insolvency of either the debtor or the junior creditor, the position is different on and after the debtor's insolvency.

Subordination on and after the debtor's insolvency

It used to be considered that contractual subordination was ineffective on the debtor's insolvency. This was because it is mandatory, under English insolvency law, that distributions be paid to the debtor's unpreferred and unsecured creditors *pari passu*. It is not possible to contract out of these mandatory provisions nor to enter into any arrangement that would give some creditors priority over others of the same class by removing an asset that would otherwise have been available to all of them.

However, the general view is now that contractual subordination does not infringe the *pari passu* principle. It has been held in the Court of Appeal that there is no rule of public policy that invalidates the postponement or subordination of a creditor's claim against the debtor. This would be the case even after the commencement of a winding up. As a creditor may voluntarily waive a debt due to him/her, there is no reason he/she should not be able to waive his/her right to prove in the insolvency of the debtor.

Set-off on and after the debtor's insolvency

For the purpose of maximizing the assets available to the senior creditor, it is usual for the junior creditor to agree not to set off the junior debt against any liabilities of the junior creditor that are due to the debtor.



However, the agreement not to set off will not be enforceable in the liquidation or administration of the debtor. This is because if the debtor goes into liquidation, the automatic set-off regime under the Insolvency Rules applies instead. Similarly, if the debtor goes into administration and the administrator has given notice under the Insolvency Rules that he/she proposes to make a distribution to creditors, the automatic set-off regime applies. The Insolvency Rules are mandatory and the parties to an agreement may not contract out of them. Although for "financial collateral" (e.g., shares, cash or securities) in respect of a "financial collateral arrangement" under the Financial Collateral Arrangements No.2 Regulations 2003, the mandatory set-off regime is dis-applied.

In order to "neutralize" the mandatory set-off regimes, it is usual to see an agreement by the junior creditor to hold on trust for the senior creditor any amounts it recovers from the debtor by set off.

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United States of America

1. Is there any prohibition on a company incorporated in the United States providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

There is no prohibition on a company incorporated in the United States of America (U.S.) providing financial assistance in connection with the acquisition of shares in itself or its parent company, unless the company or its parent company is:

- (a) a natural person, corporation, partnership, trust, limited liability company, association, governmental authority or unit, or any other entity, whether acting in an individual, fiduciary or other capacity (Person) designated by the U.S. government on the list of the Specially Designated Nationals and Blocked Persons (SDN List) with which a U.S. Person cannot deal or otherwise engage in business transactions;
- (b) a Person who is otherwise the target of U.S. economic sanctions laws so that a U.S. Person cannot deal or otherwise engage in business transactions with that Person;
- (c) controlled by (including because that person is a director or owns voting shares or interests), or acts, directly or indirectly, for or on behalf of, any person or entity on the SDN List or a foreign government that is the target of U.S. economic sanctions prohibitions so that the entry into, or performance under, the relevant agreement would be prohibited under U.S. law; or
- (d) an "investment company" or a company "controlled" by an "investment company" or a subsidiary" of an "investment company," within the meaning of the Investment Company Act of 1940.



2. What are the implications under the corporate benefit laws of United States for a company providing financial assistance?

There are three fundamental issues to be considered in relation to a company providing financial assistance as follows:

- (a) whether the company providing the financial assistance and the company that is the target or borrower are organized under the laws of the U. S., one of the fifty states or the District of Columbia;
- (b) the corporate or limited liability company laws of the relevant state; and
- (c) fraudulent transfer provisions under state law and the federal bankruptcy statutes.

Jurisdiction of organization of the relevant company

The jurisdiction of organization of the company providing financial assistance could trigger certain U.S. federal income tax issues.

Specifically, if a U.S. parent company (organized under the laws of the United States, one of the fifty states or the District of Columbia) seeks credit support from a subsidiary organized in a foreign jurisdiction that is treated as a "controlled foreign corporation" for U.S. federal income tax purposes, Section 956 of the United States Internal Revenue Code of 1986, as amended (Internal Revenue Code), could be triggered. If so, the accumulated "earnings and profits" of the foreign subsidiary will be deemed to have been distributed to the U.S. parent and subject to corporate income tax (the maximum U.S. corporate income tax rate under current law is 35%).

For the purposes of Section 956 of the Internal Revenue Code, credit support includes:

(a) guarantees by the foreign subsidiary;

- (b) pledges to a lender over the shares of the foreign subsidiary representing two-thirds or more of the voting power of the foreign subsidiary; and
- (c) security interests granted to a lender by the foreign subsidiary over its assets

As long as the credit support by the foreign subsidiary remains in place, there is a risk that all future earnings and profits of the foreign subsidiary will be deemed distributed to the U.S. parent and subject to U.S. tax as described above.

Corporate and limited liability laws

As statutes vary from state to state and in the District of Columbia, the statute of the relevant jurisdiction must be reviewed in the context of the transaction.

Most corporate and limited liability law statutes, however, permit the granting of guarantees, unless the certificate of incorporation or bylaws or certificate of formation and operating agreement, as applicable, otherwise prohibit the guarantee.

Most states require the granting of the guarantee or other financial assistance to serve a corporate purpose. Many states, such as Delaware, presume corporate guarantees granted within affiliate relationships are necessary or convenient for the conduct of the guarantor's business. However, other states, such as New York, have no such presumption and courts have held that it is appropriate to examine the relationship between the entities, the reasons behind the guarantee and whether the guarantor expects "beneficial results" from the transaction. In most states, such as Delaware, the courts generally view a corporate purpose liberally.

The relevant decision is generally made by the board of directors or managers, as applicable. The test applied in relation to a decision (in most situations) is whether the board made the determination in "good faith" and using "reasonable business judgment."



Fraudulent transfer provisions

Fraudulent conveyance concerns arise under either:

- (a) the relevant state or District of Columbia statute (the Uniform Fraudulent Conveyance Act or the Uniform Fraudulent Transfer Act); or
- (b) title 11 of the United States Code (Bankruptcy Code).

Any transfer occurring within one year of the bankruptcy of the guarantor may be set aside under the Bankruptcy Code, if the guarantor:

- (a) received less than "reasonably equivalent value" in relation to the transaction and was insolvent or became insolvent by the transfer;
- (b) was under capitalized, or rendered under capitalized by the transfer or
- (c) was unable, or rendered unable by the transfer, to pay its debts when they matured.

The most common insolvency test is on a balance sheet basis and assesses if liabilities are in excess of assets at fair market value.

The statute of limitations under state statutes is longer than the one year statute of limitations under the Bankruptcy Code. Most states, including Delaware, have a four year statute of limitations period after the transfer.

In the case of a parent guarantee of subsidiary debt (a downstream guarantee), the parent is generally viewed as having received reasonably equivalent value because it owns the subsidiary. When a guarantees is given by a subsidiary to the parent (an upstream guarantee), or to another subsidiary (a cross-stream guarantee), unless the guarantor receives all or a proportionate share of the proceeds of

the indebtedness, the courts must examine the transaction to determine if the guarantor:

- (a) received reasonably equivalent value (which may include indirect benefits); and
- (b) became insolvent by the transaction.

To address the insolvency risk, the guarantee should include language limiting the aggregate obligation of the guarantor to that amount that would not render the guarantor insolvent at the time the guarantee was made. While this approach has the disadvantage of potentially limiting the amount which might be available from a guarantor as its net worth increases and leaves open the question of how much of the guarantor's assets are available to be called on, it decreases the possibility that the guarantee will be determined to be invalid.

A fraudulent conveyance also includes transfers made with intent to hinder, delay or defraud creditors. However, a mere financial assistance transaction of itself should not invoke this liability.

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Security

Generally speaking, a lender may take a security interest over all or any portion of the assets of the borrower or guarantor. There must be a grant of the security interest to secure the obligations and there must be perfection.



The security interest is perfected by different means depending on the nature of the collateral. The security interest in:

- (a) real property is perfected by the filing of a mortgage in the appropriate county office of the state in which the real estate is located;
- (b) titled equipment, such as automobiles, by recording the liens on the title of the equipment;
- (c) U.S. registered aircraft by filing in the offices of the Federal Aviation Administration in Oklahoma City, Oklahoma and receipt of a Conveyance Recordation Notice, AC Form 8050-41, delivered to the secured party;
- (d) marine vessels by valid maritime liens and mortgages which may be filed with the U.S. Coast Guard:
- (e) certain personal property by filing of a Uniform Commercial Code (UCC) financing statement in the appropriate filing office, generally the secretary of state, in the case of:
 - (i) either a corporation or limited liability company, its state or organization or formation, as applicable;
 - (ii) a partnership in the state of its principal office; and
 - (iii) a foreign entity, the District of Columbia;
- (f) cash or securities held in a deposit account, by control through a deposit account control agreement executed by the depository institution, the lender and the grantor;
- (g) equity interests:
 - (i) if a corporation, by possession of the actual certificates issued by a corporation delivered with stock powers executed in blank:

- (ii) if a limited liability company that has opted into Article 8 of the UCC in its operating agreement to have its membership interests treated as securities, by possession of the actual certificate issued to evidence such interests delivered with stock powers executed in blank; and
- (iii) if a limited liability company that has not opted into Article 8 of the UCC, or a partnership, through the filing of a UCC financing statement to perfect in relation to general intangibles.

Other specialized types of collateral such as extracted minerals, timber, crops, insurance, rolling stock and healthcare receivables require additional actions and special counsel should be consulted in relation to aircraft and maritime liens. Interests in intellectual property may be perfected by filing a UCC financing statement, but customary practice would include an additional filing in relation to property consisting of patents, trademarks or copyrights with the U.S. Patent and Trademark Office or the U.S. Copyright Office, as applicable.

Tax

As a general matter, there are no taxes or duties payable on grants of security, merely filing fees. In some states, such as Florida, there are taxes due on commercial documents executed within the state. In those cases, documents that are subject to the laws of other jurisdictions should be executed outside states having document taxes. A very small minority of states impose a UCC filing tax. Many states impose mortgage recording taxes, which vary greatly by jurisdiction. Some states, such as Florida, impose taxes on contractual agreements signed within the state.



4. How long, following acquisition of a foreign target company, would it usually take in United States for a United States subsidiary of that foreign target company to grant a guarantee/security?

In an acquisition, the guarantee is generally provided and the security interest granted at the same time as the closing of the acquisition and the entry into the loan documents.

Under Section 547(e) of the Bankruptcy Code, a security interest that is not perfected within 30 days of the closing will be deemed to be a grant in respect of an antecedent debt and may be avoidable as a preference. The preference period extends to transfers within a 90 day period prior to the bankruptcy petition filing, but runs for a period of one year prior to the petition date for "insiders". "Insiders" include entities that hold more than 20% of the voting securities in the debtor or entities or entities in which the debtor holds more than 20% of the voting securities.

5. Are there any restrictions on foreign banks lending to companies in United States? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

There are no restrictions *per se* on foreign banks lending to companies in the U.S. However, other general prohibitions, such as those prohibiting transactions with Persons on the SDN List, are operative. A mere extension of credit from, or a grant of security to, a lender outside the U.S. should not cause a lender to be licensed to do business. However, certain states, such as Alabama, mandate that any contract with a party not qualified to do business in the state is *void ab* initio

Withholding tax

Interest paid to a foreign bank on an extension of credit made under a loan agreement entered into in the ordinary course of the foreign

bank's trade or business is generally subject to a 30% U.S. withholding tax, unless the tax is reduced or eliminated by an applicable income tax treaty. A foreign bank will need to provide to the payer of the interest a certificate of foreign status on an applicable Internal Revenue Service Form W-8 (i.e., Form W-8BEN). This form is also used by foreign banks to claim any reduction in the U.S. withholding tax rate under a relevant income tax treaty.

If a foreign bank makes passive investments in the United States and derives interest income from those investments (i.e., the bank is not extending credit to a U.S. borrower under a loan agreement in the ordinary course of its trade or business), that U.S.-source interest income may be eligible for an exemption from U.S. withholding tax if it qualifies as "portfolio interest." For a foreign bank to claim the portfolio interest exemption in this instance, the foreign bank must not own 10% or more of the payer of the interest, the foreign bank must provide an applicable Internal Revenue Service Form W-8 to the payer, and the underlying instrument to which the interest payments relate must be treated as a "registered obligation" under the portfolio interest rules.

FATCA

Interest payments to a foreign bank are also subject to a 30% U.S. withholding tax under the Foreign Account Tax Compliance Act (FATCA) (codified in Sections 1471 through 1474 of the Internal Revenue Code and the Treasury Regulations proclaimed under the Internal Revenue Code), unless the foreign bank complies with certain due diligence and reporting requirements prescribed by FATCA. The manner of compliance with FATCA by a foreign bank will be determined in part by the jurisdiction in which the bank is located and whether the government of that jurisdiction has entered into a FATCA intergovernmental agreement with the U.S.

If an intergovernmental agreement is in place, a foreign bank will generally need to comply with the due diligence requirements in that agreement, and report U.S. owner information to the tax authorities in



its own jurisdiction, to be FATCA compliant and avoid the 30% FATCA withholding tax. If there is no FATCA intergovernmental agreement in place between the jurisdiction of a foreign bank and the U.S., the foreign bank will generally need to report U.S. owner information directly to the U.S. tax authorities to be FATCA compliant and avoid the 30% FATCA withholding tax. The FATCA rules contain coordination provisions that prevent the FATCA withholding tax and the "regular" 30% U.S. withholding tax described above from both applying to a single payment.

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in United States, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

The market custom is to obtain commitment letters from the lenders that contain "certainty of funding" or "SunGard" language. The purpose of "SunGard" language is to reduce the number and scope of conditions precedent to the initial funding of the loans so there is more certainty for the seller that the financing will be available and the acquisition will close. The representations and warranties are limited to certain "specified representations" and the "material adverse effect" or similar language is the same as that in the acquisition agreement on the closing date.

Also, delivery of guarantees and perfection in relation to collateral requires commercially reasonable efforts to make delivery by the closing date, but otherwise to deliver those items on mutually agreed terms. If a portion of the proceeds is to be provided from high yield markets, bridge loans are generally provided. In a minority of instances, the loan documents are negotiated and executed, but not effective until the acquisition is consummated. There is no legal concept of a "certain funds requirement."

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Under the Bankruptcy Code, a debtor may be reorganized (chapter 11) or liquidated (chapter 7). A liquidation under state law is a liquidation of the assets by an exercise of remedies arising under the security agreements and the UCC of the applicable state or it could be an assignment for the benefit of creditors under state law by which the debtor turns over the assets to a trustee for liquidation. Whether proceedings are pursued under the Bankruptcy Code or under state laws depends on the particular circumstances.

Under Section 1129(b)(2) of the Bankruptcy Code, the priority of creditor claims and other interests (e.g., equity holders) are paid in the following descending order of priority:

- (a) secured creditor claims;
- (b) unsecured creditor claims; and
- (c) other interests by class.

Under Section 506 of the Bankruptcy Code, a creditor having an allowed claim secured by a security interest in property in which the estate has an interest, or a set-off claim against property in which the estate has an interest, has a secured claim to the extent of the lesser of the amount of that claim and the value of the property of the estate, determined in light of the purpose of the valuation and the proposed disposition or use of the property. The amount of any allowed claim in excess of the property valuation would be unsecured. However, to the extent the value of the property exceeds the claim, interest on the claim may be allowed.

The priorities of the various unsecured claims are set out in Section 507 of the Bankruptcy Code. In a Chapter 7 liquidation, Section 726 of the Bankruptcy Code provides that distributions to the debtor are



made only after all other expenses and claims are paid in full. The "absolute priority rule" would extend this concept to a reorganization under Chapter 11.

The "absolute priority rule" embodied in Section 1129 of the Bankruptcy Code provides that:

- (a) each holder of a claim will receive no less than the amount to which that holder would have been entitled in a Chapter 7 liquidation; and
- (b) no junior class of claim or interest may receive any property under a plan of reorganization unless the senior class has received property, as at the date of that plan, of value equal to the senior creditors' claims.
- 8. Is interest on debt incurred to acquire a company in United States deductible for tax purposes? Are there any thin capitalization thresholds?

Interest on debt incurred to acquire a company in the US is generally deductible, subject to the application of various limitation rules.

For example, the deductibility of interest may be denied if a debt instrument constitutes an "applicable high yield discount obligation" (**AHYDO**) under Section 163(e)(5) of the Internal Revenue Code. A debt instrument will generally be treated as an AHYDO if:

- (a) the maturity date of the instrument is more than five years from the date of issue;
- (b) the yield to maturity on the instrument equals or exceeds five percentage points plus the "applicable federal rate"; and
- (c) the instrument has "significant original issue discount."

A debt instrument is considered to have "significant original issue discount" if the aggregate amount of income that has been recognized

on the instrument as at the close of any period ending more than 5 years after the issue of the debt instrument is greater than the sum of:

- (a) the actual interest paid prior to that period; and
- (b) the product of (x) the issue price of the debt instrument and (y) its yield to maturity.

The deductibility of interest may be denied or deferred under the "thin capitalization" rules in Section 163(j) of the Internal Revenue Code, if the interest is paid to a related party and the debt-to-equity ratio of the corporate borrower exceeds 1.5 to 1.0 (i.e., 60% debt and 40% equity). For this purpose, two corporations are considered related if they are linked by a greater-than-50% stock ownership.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in United States?

A subordination agreement is enforceable in bankruptcy proceedings, under Section 510 of the Bankruptcy Code, to the same extent that a subordination agreement would be enforceable under applicable non-bankruptcy laws. However, after notice and hearing, the court may subordinate all or any part of an allowed claim based on principles of equitable subordination, which is a very limited remedy to creditors harmed by inequitable conduct causing public harm.

In any liquidation under state law a subordination agreement would be enforceable to the extent it is an enforceable contract under the applicable state law. Subordination can relate to liens (priority of recovery) or debt (right of payment).

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Venezuela

 Is there any prohibition on a company incorporated in Venezuela providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

Venezuelan law contains no statutory provision limiting or prohibiting a company incorporated and domiciled in Venezuela from providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate).

However, the company's corporate authorization of a transaction by which it provides financial assistance must be reviewed based on the content of its articles of incorporation / bylaws. If the company is a special entity (bank, insurance company, public issuer of securities, among others), a state-owned corporation or any other public sector entity, specific research is required to determine if there is any prohibition or limitation on providing financial assistance. This is due to the fact that special entities, public entities and corporations owned and/or controlled by the republic, the states or other Venezuelan public entities are heavily regulated.

2. What are the implications under the corporate benefit laws of Venezuela for a company providing financial assistance?

Venezuelan law regulates as follows the duties of a director of a Venezuelan company, and in particular, the situations that can give rise to personal/criminal liability.

General duties, responsibilities and liabilities of the directors of a Venezuelan company

The scope of potential civil liability is set out below in relation to the director's relationship with, and responsibility to, each of the following categories of persons/ entities:

- (a) the company itself;
- (b) the shareholders of the company (in their capacities as individuals); and
- (c) third parties whom the director deals with on behalf of the company.

Also, there are several laws providing for criminal liability that a director of a company risks incurring in the exercise of his/her office. While some crimes expressly require that the perpetrator be a director and/or manager of the company, other crimes, even if perpetrated by any other officer of the company, imply a special risk for directors and/or managers, because they relate to the activities in which managers would usually engage. Criminal liability of corporate directors is mainly covered by the provisions of the Venezuelan Code of Commerce (published in the Special Official Gazette No. 475 dated 23 July 1955)⁵² (Commercial Code). However, there are many laws and regulations in other areas such as banking, tax, customs, narcotics, intellectual property, consumer protection, labor, environmental and antitrust, which contain provisions in relation to possible criminal liabilities for corporate directors.

Directors' relationship with the company

Under Article 243 of the Commercial Code, a contractual relationship exists between a company and a director of that company. A director is liable to the company for damages resulting from a breach by the director of the terms and conditions of that contract under Articles 1,264 and 1,689 of the Venezuelan Civil Code (published in the Special Official Gazette No. 475 dated 23 July 1955) (Civil Code).

The terms and conditions of the director-company relationship are those specifically set out in the articles of incorporation/bylaws of the company, as well as those arising from specific statutory provisions. Directors may not exceed the powers conferred on them under the

⁵² Published in the Special Official Gazette No. 475 dated 23 July 1955.



articles of incorporation/bylaws of the company⁵³. If the directors attempt to exercise unauthorized powers, they will be liable to the company (as well as to affected third parties) for any harm caused by the unauthorized action⁵⁴

Under Venezuelan law, directors must act with good faith and diligence. Article 1,160 of the Civil Code provides that contracts (including directors' obligations to their companies) are to be performed not only in strict compliance with their terms, but also in accordance with principles of equity, usage in the trade and the law. Articles 1,270 and 1,692 of the Civil Code provide that corporate directors, as parties to an implied contract of mandate (which is a contract under which one party agrees to perform certain acts for another person), must exercise the degree of diligence in the conduct of corporate affairs that a "good father of a family" would exercise in the conduct of the family's affairs. This admittedly vague concept is analogous to the standard of conduct of a "prudent man conducting his own affairs." Therefore, under Venezuelan law, directors will not be liable for losses sustained by the company from decisions made or actions taken, only if:

- (a) those decisions were made or actions were taken in the ordinary course of the company's business; and
- (b) the directors have put in their best efforts (i.e., satisfied their duty of care and diligence) to seek to obtain a successful outcome in relation to those actions or decisions.

The Commercial Code also imposes certain affirmative duties and specific restraints on corporate directors in the conduct of the company's affairs. It appears that the purposes underlying these provisions of law are to:

⁵⁴ Commercial Code, Article 243; Civil Code, Article 1,185

⁵³ Commercial Code, Articles 243 and 266 (4); Civil Code, Article 1,689

- (a) assure proper shareholder supervision and control over the conduct of corporate affairs; and
- (b) protect third parties in their dealings with the company.

Directors who fail to perform required duties or who act counter to specific restraints imposed by law are liable to the company for any losses suffered as a result of the relevant misconduct⁵⁵.

As noted above, the Commercial Code imposes certain restraints on directors' actions, largely to ensure the integrity of the corporate capital. Therefore, directors are prohibited from causing the company to purchase its own shares unless that purchase:

- (a) is specifically authorized by a shareholders' meeting; and
- (b) is made with funds provided for the purpose of purchasing its own shares from regularly obtained profits as shown in the company's financial statements⁵⁶.

Similarly, the directors may not declare dividends unless the company has sufficient retained earnings to pay those dividends⁵⁷. Finally, directors will be liable to any party (the company or a third party) that suffers loss as a result of the directors making a false statement about the paid-in capital of the company⁵⁸.

Generally, all directors are jointly liable to the company for losses sustained as a result of a wrongful action of a director⁵⁹. A "wrongful action" is a breach of a director's fiduciary duty or any decision beyond the scope of the director's powers. Directors may, however, exonerate themselves from liability by showing that they took no part

⁵⁷ Commercial Code, Article 266 (2)

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⁵⁵ Commercial Code, Articles 243, 266(4)

⁵⁶ Commercial Code, Article 263

⁵⁸ Commercial Code, Article 265 (2)

⁵⁹ Commercial Code, Article 266



in the misconduct and that they attempted to prevent it. To satisfy the burden of proof, the director seeking exoneration must show that:

- (a) he/she tried to dissuade the other directors from taking wrongful action;
- (b) his/her vote in opposition was duly recorded in the minutes of the meeting at which the wrongful action was taken or authorized; and
- (c) he/she immediately informed the statutory auditors of the other directors' wrongful action.

It should be emphasized that it is not sufficient for a director to show that he/she took no part in the deliberations leading to the wrongful action; he/she must show affirmative efforts in opposition to the relevant action.

Directors' relationship with shareholders

A resolution of a shareholders' meeting is required to authorize legal proceedings against directors for breach of any obligations owed to the company⁶⁰. Venezuelan law makes no provision for an action by a shareholder, on behalf of the company (i.e., a shareholder's derivative action), against the directors for harm to the company caused by director wrongdoing, and relevant legal authorities confirm that the right of a shareholder to maintain a derivative suit does not exist under Venezuelan law

Directors' liability to third parties

Since directors are responsible for representing the company in dealings with third parties, they may be exposed to liability to third parties who suffer harm in dealing with the company as a result of the directors' misconduct. The three general categories of potential "victims" are:

⁶⁰ Commercial Code, Article 310

- (a) potential investors;
- (b) corporate creditors; and
- (c) parties entering into contracts with the company.

A director who provides false information about the company to the public is liable to any person harmed by that act⁶¹. This liability is applicable in situations in which directors induce persons to invest in the company by providing them with false information or misrepresent the true facts about the company. Persons engaging in this form of misconduct may also be subject to criminal penalties⁶².

Directors are legally responsible for the truth of any statements made regarding the paid-in capital of the company⁶³, for the existence of dividends paid⁶⁴, and for representations made to creditors⁶⁵. A director who violates any of these provisions in dealing with any third party, including any creditor, is liable for the harm suffered by his/her actions.

Directors may act on behalf of the company only within the scope of the authority granted to them by law and by the articles of incorporation/by laws. The company is not liable to third parties for any obligation undertaken by the directors if undertaking that obligation is outside the scope of the directors' authority ⁶⁶. Although the company is not liable for the undertaking, the directors who acted beyond their authority are personally liable to any third party harmed by the undertaking of the relevant obligation ⁶⁷. Therefore, if the directors cause the company to enter into a contract for which prior shareholders' approval is required (but not obtained), the company is

⁶² Commercial Code, Article 370

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⁶¹ Civil Code, Article 1,185

⁶³ Commercial Code, Article 266 (1)

⁶⁴ Commercial Code, Article 266 (2)

⁶⁵ Civil Code, Article 1,185; cf., Commercial Code, Article 370

⁶⁶ Civil Code, Article 1,698

⁶⁷ Commercial Code, Article 243



not bound by the contract, but the other party may proceed against the directors. ⁶⁸

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

Security generally under Venezuelan law

Venezuelan law distinguishes between guarantees (*garantías personales*) and security interests in assets (*garantías reales*). A guarantee is an unsecured promise by a third party guarantor to the creditor to pay the debtor's obligation. The most common types of guarantees are general guarantees (*fianzas*) and guarantees of negotiable instruments (*avales*).

A security interest in property involves the perfecting of a lien on specific assets. The most common security interests in property are the mortgage of real property, the civil law pledge (also known as the "ordinary pledge), the "special pledge" (which is a type of pledge under which the pledgor retains possession of the collateral) and the chattel mortgage.

Security over shares and other assets

The most common types of security granted over shares and other assets under Venezuelan law are set out below.

Pledge of shares of Venezuelan corporations

Shares of Venezuelan corporations are Venezuelan *situs* assets. Therefore, the creation and perfection of a pledge is necessarily governed by Venezuelan law. A pledge over shares is a security interest that grants the pledgee the right, on default, to institute

⁶⁸ Civil Code, Article 1,698; Commercial Code, Article 243

foreclosure proceedings and satisfy the pledgee's claim from the proceeds of the judicial sale of the pledged shares.

To perfect a pledge of shares in a Venezuelan corporation, the appropriate entry in the stock register of the company must be signed by the pledgor and the pledgee. If there are share certificates, the relevant share certificates must be endorsed as having been pledged and delivered to the pledgee. Under the share pledge agreement, the pledgor may agree to transfer to the pledgee, among others, the right to dividends and the right to exercise the voting rights vested in the shares. One of the advantages of a pledge of shares is that it is a security interest that may be perfected at a very low cost.

Mortgage of real property

A mortgage is a security interest in real property that grants the mortgagee the right to pursue the real property as against the entire world and to recover the amount due from the proceeds obtained at the judicial auction of the mortgaged real property.

The mortgage secures the real property and all accessories, fixtures, and improvements. A valid mortgage requires identification of the realty, the amount to be secured and a statement of the obligation that is secured by the mortgage. More than one mortgage may be granted over the same real property. If that happens, the priority of the secured creditors is determined by reference to the registration dates of the mortgages, with an earlier registered mortgage having priority over a later registered mortgage over the same property.

The validity of a mortgage is subject to compliance with certain formal requirements. The mortgage deed must be registered in the Public Registry Office of the jurisdiction where the real property is located. Registration of the mortgage deed is also subject to a registration fee of 0.25% of the amount of the mortgage, plus additional out-of-pocket registration charges.



Chattel mortgage

The Chattel Mortgage Law⁶⁹ (**Chattel Mortgage Law**) provides for the creation of chattel mortgages over assets such as:

- (a) motor vehicles;
- (b) aircraft;
- (c) industrial equipment; and
- (d) intellectual and industrial property rights.

To perfect each of these types of chattel mortgage, an executed public document must be recorded in the appropriate Public Registry Office, which depends on the nature of the asset to be mortgaged. Registration fees and other fees are the same as those applicable to real property mortgages. Out-of-pocket expenses may vary.

Under the Chattel Mortgage Law, only certain types of persons are entitled to be granted a chattel mortgage once the corresponding ministry issues the relevant authorization. These persons are banking institutions, insurance companies and entities authorized by the Office of the Superintendant of Financial Institutions or the Ministry of Agriculture. However, the Republic of Venezuela states that municipalities, governmental entities, local banks and local insurance companies do not require prior authorization. Foreign financial institutions must obtain the prior authorization of the Office of the Superintendent of Banking Sector Entities. To obtain the authorization, the creditor must submit an application providing a complete description of the assets to be pledged and comply with several other formal requirements.

A chattel mortgage is advantageous because the mortgagor need not surrender possession. Also, it entitles the mortgagee to pursue the mortgaged assets wherever located and regardless of who holds them.

⁶⁹ Published in Special Official Gazette No. 1,575 dated 4 April 1973.

The disadvantage is that the mortgagee does not have direct control over the mortgaged assets, which remain in the possession of the debtor. Nevertheless, the Chattel Mortgage Law provides for criminal sanctions if the mortgagor sells or disposes of the mortgaged assets or creates any other security interest in the mortgaged assets without the creditor's prior consent. Further disadvantages include the need to comply with formalities and registration requirements, which may involve delays, as well as the costs and registration fees involved in the perfection of this type of security interest.

Taxes and fees

The notarization and/or registration of the relevant documents will be subject to stamp or registration tax liability and also to service fees. The amount of the stamp tax/service fees will depend on the nature of the property (as real estate requires registration at the real estate registry where the property is located but other types of property only require notarization), the length of the document and the value of the assets. Therefore, for example, in the case of mortgages of real property located outside the Caracas Capital District, the following stamp/registration tax and services fee may apply:

- (a) a service fee of up to 0.40% of the real property's value (the highest rate applies to real property whose value exceeds 6,501 tax units);
- (b) a service fee of 0.03 tax units for each page of the document to be registered;
- (c) a service fee of 0.05 tax units for each witness signing the document (applicable to the extent that the document is not submitted by the interested party); and
- (d) a registration tax of up to five tax units for real estate property whose value exceeds 6.501 tax units.



Subject to annual adjustments on the basis of the preceding fiscal year's inflation, the 2015 tax unit value is VEB127 or USD20.15 at the official rate of exchange of VEB6.3 per USD1.

4. How long, following acquisition of a foreign target company, would it usually take in Venezuela for a Venezuelan subsidiary of that foreign target company to grant a guarantee/security?

There is no specific time frame for the granting of a guarantee/security by a Venezuelan company. The timing usually depends on:

- (a) the complexity of the financing and security structure; and
- (b) the corporate authorizations of the Venezuelan company and special permits required, if any.
- 5. Are there any restrictions on foreign banks lending to companies in Venezuela? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks

The general rule under Venezuelan law is that foreign banks may lend to companies in Venezuela. However, non-licensed foreign banks are restricted under the Law for the Banking Sector Entities published in Official Gazette No. 40,557 of December 8, 2014 (**Banking Law**) in relation to the activities that they can perform in Venezuela. In general, non-licensed foreign banks are prevented from performing any financial intermediation or business activity in Venezuela.

Also, it should be noted that exchange controls were introduced in 2003 and currently remain in force in Venezuela. The exchange control regulations provide for a limited and restricted market for the purchase and sale of foreign currency in Venezuela. Therefore, the borrowing company must repay the loan in foreign currency with its own funds held outside of Venezuela and not subject to mandatory sale to the Central Bank of Venezuela.

Tax

Under the Income Tax Law published in the Official Gazette 38,628 of 16 February 2007 (**Income Tax Law**) (Article 6(c)) interest paid in respect of a loan, the proceeds of which are invested in the borrower's Venezuelan business, is subject to Venezuelan income tax liability regardless of the nationality or domicile of the lender, the place of execution of the loan agreement, the place where the proceeds are delivered to the borrower, the place where the principal and interest on the loan is payable or the currency of payment.

According to the recognition rules contained in the Income Tax Law, interest arising from loans granted by banks, insurance companies, or other credit institutions, as well as any other type of corporations, is only deemed to be recognized on the basis of the interest accrued in the corresponding fiscal year. Therefore, regardless of actual payment, interest will be taxed on a mandatory accrual basis. Under Article 552 of the Civil Code, interest is deemed to be accrued on a daily basis unless the terms of the loan provide otherwise.

Under the Income Tax Law (Article 52 paragraph 1), interest paid to foreign financial institutions is subject to income tax liability in Venezuela at a 4.95% flat rate, as opposed to the normal 34% corporate rate applicable to interest paid to non-financial institutions. The entire income tax liability on the interest will be subject to a back-up withholding. Back-up withholding is a mechanism for collecting and/or anticipating the income tax in most cases due by foreign non-domiciled entities without a permanent establishment in Venezuela. The withholding is applied by the payer on payment or constructive payment of the relevant income (e.g., interest income).



6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Venezuela, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

The Rules regarding Public Offering of Acquisition, Exchange or Takeover of Entities that make Public Offering of Shares and other Rights over the Same published in Official Gazette No. 37,039 of September 19, 2000 (**OPA Rules**) regulate the acquisition of shares through a public offering of acquisition (**OPA**) of entities publicly offering their shares or rights of any nature (**Offerees**). Under the OPA Rules, any person, including investment banks and securities brokerage firms that provide or coordinate the financing of the OPA will be considered to be collateral offerors⁷⁰.

The offeror of the shares (**Offeror**) must provide the necessary information so that the Offeree can decide, in a conscious and reasoned manner, whether to proceed or not with the sale of their shares on the conditions offered. The Offeror must therefore file with the Office of Superintendent of National Securities (**NSS**) a clear and precise report that must include, among other things, the payment conditions and the guarantees offered to the Offerees⁷¹.

The Offeror may pay the price of the shares in cash or securities.

If the payment is made in cash, the Offeror must guarantee payment by a mechanism such as a trust, guarantee, letter of credit or any other type of security that satisfies the NSS. The Offeror must also respond to any obligations that may be derived from the offer or its revocation. Also, all of the Offerors must provide a joint and several guarantee⁷².

If payment is made with securities, the Offeror must guarantee the delivery of the securities by means of a trust or other mechanism that

⁷¹ OPA Rules, Article 6

⁷⁰ OPA Rules, Article 5

⁷² OPA Rules, Article 22

allows the Offeror to secure the timely delivery of the securities offered, to the satisfaction of the NSS⁷³.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Under Venezuelan law, companies are subject to:

- (a) the moratorium (*atraso*) benefit (**Moratorium**), which consists of a benefit that may be granted by a court to companies whose assets exceed their liabilities but, due to lack of liquidity of assets, are unable to pay their debts at maturity; and
- (b) bankruptcy proceedings (**Bankruptcy**), which apply to companies that:
 - (i) are generally unable to pay their debts at maturity; and
 - (ii) do not meet the requirements to be entitled to a Moratorium.

Together Moratorium and Bankruptcy are referred to below as the **Ordinary Insolvency Regime**.

Bankruptcy is neither a protection nor a benefit. In the ordinary course of events, Bankruptcy leads to the liquidation of the bankrupt estate by the trustee or receiver appointed by the bankruptcy court.

The Ordinary Insolvency Regime is regulated by the Commercial Code.

Regulated entities domiciled in Venezuela are subject to special insolvency regimes.

In general terms, companies declared bankrupt will pay their debts in the following order: ⁷⁴

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⁷³ OPA Rules, Article 25



- (a) debts vis-à-vis privileged creditors privileged creditors are mainly employees of the company and other creditors holding special civil law privileges including the tax administration;
- (b) debts vis-à-vis secured creditors, up to the price of sale of the collateral - secured creditors are those holding a security interest or lien over specific assets of the debtor; and
- (c) debts vis-à-vis non-privileged creditors these debts will be paid on a *pro rata* basis.
- 8. Is interest on debt incurred to acquire a company in Venezuela deductible from earning for tax purposes? Are there any thin capitalization thresholds?

As a general proposition, the following four concurrent requirements must be met for an expense to be deducted:

- (a) the expense must be incurred;
- (b) it must qualify as ordinary and necessary;
- (c) it cannot be imputable to the cost; and
- (d) it must be performed in the country in order to produce the taxpayer's Venezuelan-source income.

Also, although the withholding tax is not technically a specific requirement to deduct expenses whose payments are subject to withholding, note that there is a legal presumption by virtue of which the expenses subject to withholding will be deemed as not made when the payer has failed to withhold and pay the corresponding tax within the terms and conditions established in the Withholding Decree. Notwithstanding that the abovementioned presumption might be rebutted by means of the proof of the effective performance of the expense, the sole failure to perform the applicable withholding

⁷⁴ Commercial Code, Article 1,041

(together with the sanctions and joint and several liability caused by the breach) implies that there are activities to prove that might complicate the deduction of the amounts paid as interest.

In addition to the requirements mentioned above, if the lender and the borrower are related parties, the deduction of the interest is subject to the thin capitalization rules at a 1:1 debt-equity ratio.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Venezuela?

Under Venezuelan law, contractual subordination will not be recognized by a bankruptcy trustee.

The debt payment order indicated in the answer to question 7 is mandatory and cannot be waived. National commentators have said that:

- (a) the order of priority arises from the law and operates automatically, without the possibility of creating privileges by means of private agreements; and
- (b) rules that create privileges (such as the Commercial Code) constitute exceptions to the principle that all creditors have an equal right over the assets of the company in bankruptcy.

Therefore, these rules are to be interpreted restrictively.

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Vietnam

 Is there any prohibition on a company incorporated in Vietnam providing financial assistance in connection with the acquisition of shares in itself or its parent company (either direct or ultimate)?

The Civil Code 2005 (Civil Code), the Law on Enterprises 2005 (Enterprise Law) and the Ordinance on Foreign Exchange are the main "legal documents" governing the provision of financial assistance by a company to any other entity.

In general, the Civil Code and the Enterprise Law do not expressly prohibit or allow the provision of financial assistance by a company to a person who is acquiring shares⁷⁵ in that company or its parent company. Currently, companies established in Vietnam are not yet allowed to extend loans or provide guarantees to offshore entities without approval from the Prime Minister.

The extension of loans by companies established in Vietnam to local borrowers is not straight-forward. According to an official dispatch issued by the State Bank of Vietnam in April 2013, only credit institutions are permitted to conduct lending as a regular activity. Other enterprises may only lend on an irregular basis. That being said, there is no specific guidance on what constitutes "lending as a regular activity." Therefore, providing financial assistance by way of corporate lending should be undertaken with caution because doing business without a license could be subject not only to administrative fines but also to criminal sanctions in the form of fines or even imprisonment.

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⁷⁵ Under Vietnamese law, only a joint stock company can issue shares. Other corporate forms such as single-member limited liability companies and multi-member limited liability companies are not permitted to issue shares. This paper discusses the possibility of provision of financial assistance in relation to joint stock companies and limited liability companies. For limited liability companies, "shares" will be understood as "capital contribution."

A public company may not extend loans to its shareholders or a related person. ⁷⁶ A public company may also not extend loans to its board members or management personnel or their related persons unless decided otherwise by a general meeting of shareholders. ⁷⁷ A public company is defined as a joint stock company falling into one of the following three categories:

- (a) it is a company that has already carried out a "Public Securities Sale Offering";
- (b) it is a company that has its share certificates listed on a Stock Exchange or Securities Trading Centre; or
- (c) it is a company that has its share certificates owned by at least 100 "Investors" not including "Securities Institutional Investors", and has an already-contributed charter capital amounting to VND10 billion or more.

Also, if the person who is obtaining the financial assistance is considered a related person of the company, a number of conditions must be satisfied before the financial assistance can be provided.

A "related person" is defined as an organization or individual having a direct or indirect relationship with an enterprise in the following wavs:⁷⁸

- (a) the parent company, the manager of the parent company, and the person having the authority to appoint that manager *vis-à-vis* a subsidiary;
- (b) a subsidiary vis-à-vis a parent company;

⁷⁶ Circular No. 121/2012/TT-BTC dated 26 July 2012 (Circular No. 121).

⁷⁷ Circular No. 121.

⁷⁸ Article 4(17) of the Enterprise Law



- (c) a person or a group of persons capable of controlling the decisionmaking and/or activities of the enterprise through the enterprise's managerial bodies;
- (d) the enterprise manager;
- (e) the wife, husband, father, adoptive father, mother, adoptive mother, children, adopted children, and biological siblings of the enterprise manager or of the member owning a controlling capital contribution portion or of the shareholder holding controlling shares;
- (f) an individual authorized to represent a person provided in points (a), (b), (c), (d) or (e) above;
- (g) an enterprise in which a person provided in points (a), (b), (c), (d),
 (e) or (f) above or (h) below holds an ownership reaching a level sufficient to control the decision-making of its managerial bodies;
- (h) a group of persons who agree to collaborate jointly in order to take over capital contribution portions, shares or interests in a company, or to control the decision-making of a company.

As required in the Enterprise Law, if the person who obtains the financial assistance is considered a related person of the company, approval of the General Meeting of Shareholders (**GMS**) or the Board of Management (**Board of Management**)⁷⁹/Board of Members⁸⁰ (**Board of Members**) must be obtained before the financial assistance can be provided. For single-member limited liability companies.

⁸⁰ i.e., the Board of Members of a single-member limited liability company or multi-member limited liability company.

⁷⁹ i.e., the Board of Management of a joint stock company.

The matter must be considered and approved by the Board of Members or company president, director or general director, and controller(s) on a majority basis with one vote for each person.⁸¹

For multi-member limited liability companies

The matter must be examined and approved by the Board of Members.

The principle is that the matter must be approved by the number of members representing at least 75% of the total amount of voting capital. A member involved in that transaction is not entitled to cast a vote on the matter.⁸²

For joint stock companies

Any financial assistance granted to the company by any of the following entities must be approved by a GMS or the Board of Management:⁸³

- (a) a shareholder, or an authorized representative of a shareholder, owning more than 35% of the total number of common shares in the company or his/her/its related persons;
- (b) a member of the Board of Management or the director or general director; or
- (c) enterprises in which the members of the Board of Management, members of the control committee, director or general director, and other managerial personnel of the company (Managerial Personnel) own a capital contribution portion or shares, or enterprises in which the Managerial Personnel's related persons, together or separately, own a capital contribution portion or shares that is more than 35% of the charter capital.

⁸³ Article 120 (1) of the Enterprise Law.

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⁸¹ Article 75(1) of the Enterprise Law.

⁸² Article 59(1) of the Enterprise Law.



In any of the circumstances in (a) to (c) apply, the matter must be considered and approved by a GMS or the Board of Management.

The Board of Management has jurisdiction to approve the giving of financial assistance that is less than 50% of the total value of the enterprise's assets (as stated in its most recent financial statements). Financial assistance that is not less than 50% of the total value of the enterprise's assets (as stated in its most recent financial statements) (and therefore not within the Board of Management's jurisdiction) must be approved by the GMS. If the matter is within the GMS's jurisdiction, the matter will be approved when it has the consent of the number of shareholders (excluding related shareholders) representing 65% of the total number of votes. 84

As a general rule, financial assistance provided to shareholders or their related persons will be invalid and dealt with in accordance with provisions of law when entered into or performed without having been approved in accordance with the rules described above. The representative at law of the company and the relevant shareholder, a member of the Board of Management, or director or general director, and their related persons must pay compensation for damage that arises and return to the company gains generated from performing the transaction 85

Further, if the financial assistance relates to the remittance of money out of Vietnam, a review of the regulations on foreign exchange should be considered.

2. What are the implications under the corporate benefit laws of Vietnam for a company providing financial assistance?

In general, Managerial Personnel of a company have a duty to act in good faith for the benefit of the company as a whole and for a proper

⁸⁴ Article 120(2) and Article 120(3) of the Enterprise Law Articles 59(2), 75(3), and 120 (4) of the Enterprise Law.

purpose. This duty arises under the provisions of the Enterprise Law as follows.

For single-member limited liability companies

A member of the Board of Members (**BOM Member**), the company president, the director or general director, and the controller(s) must.⁸⁶

- (a) comply with the law, the company charter, and the decisions of the company owner in exercising the authority and performing the duties delegated to them;
- (b) exercise the authority and perform the duties delegated to them honestly, diligently and to the best of their ability, to ensure the maximum legal interest of the company and the company owner; and
- (c) act in a fiduciary capacity for the benefit of the company and the company owner, refrain from making use of information, knowhow and business opportunities, and refrain from abusing their title or position or the assets of the company for personal gain or for serving the benefit of another organization or individual.

For multi-member limited liability companies

A BOM Member and the director or general director must:87

- (a) exercise the authority and perform the duties delegated to them honestly, diligently and to the best of their ability, to ensure the maximum legal interests of the company and the company owner; and
- (b) act in a fiduciary capacity for the benefit of the company and the company owner, refrain from making use of information, knowhow and business opportunities of the company, and refrain from

Article 72(1) of the Enterprise Law
 Article 56(1) of the Enterprise Law



abusing their title or position or the assets of the company for personal gain or for serving the benefit of another organization or individual.

For joint stock companies

The members of the Board of Management (**BOMG Member**), the director or general director, and other managerial personnel must:⁸⁸

- (a) exercise the authority and perform the duties delegated to them in strict compliance with relevant laws, the company charter and the resolutions of the GMS;
- (b) exercise the authority and perform the duties delegated to them honestly, prudently and to the best of their ability to ensure the maximum legal interests of the company and the company's shareholders; and
- (c) act in a fiduciary capacity for the benefit of the company and the company's shareholders, refrain from making use of the information, know-how and business opportunities of the company, and refrain from abusing their title or position or the company's property/assets for personal gain or for serving the benefit of another organization or individual.

In performing its functions and duties, the Board of Management must comply strictly with the provisions of law, the company charter and the resolutions of the GMS.⁸⁹

If a resolution adopted by the Board of Management is inconsistent with the provisions of law or the company charter and this causes damage to the company, the BOMG Member(s) who approved that resolution must jointly take personal liability for that resolution and

89 Article 108(4) of the Enterprise Law

⁸⁸ Article 119(1) of the Enterprise Law

compensate the company for the damage. The BOMG Member(s) who objected to that resolution are exempt from liability. ⁹⁰

3. What security can typically be granted over shares and assets? What are the technical requirements (e.g., notarization, registration, government approval, etc.)? Is any tax or duty payable on grants of security and if so, what is the basis for calculation?

The most typical types of security taken in acquisition finance transactions over property in Vietnam include (together, **Secured Transactions**):

- (a) for shares⁹¹:
 - (i) share mortgages for shares other than those of a listed company; and
 - (ii) share pledges for listed shares;
- (b) for land use rights (**LURs**) and assets attached to land, including future assets (such as buildings under construction), security in the form of real property mortgages; and
- (c) for movable assets, asset mortgages or pledges.

There are also specific regulations related to aircraft and sea-going vessels mortgages.

The law requires that secured transactions be in written form. Under certain circumstances, notarization and registration of Secured Transactions are required in order for the Secured Transactions to be valid and enforceable. 92 However, registration of secured transactions

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⁹⁰ Article 108(4) of the Enterprise Law

⁹¹ Charter capital, share and equity in this context have been referred to as "share."

⁹² Articles 9 and 10 of Decree No. 163.



is recommended, even when not strictly required, to more effectively secure priority of payment if enforcement takes place in relation to an asset that is subject to more than one security interest.

LURs cannot be mortgaged to an offshore entity. Mortgages over real property (LURs and assets attached to land) must be notarized at a notary office and then registered with the land registry under the provincial-level Department of Nature, Resources and Environment.

There is no stamp duty in Vietnam. However, there are stamp dutylike fees such as notarization and registration fees the details of which are described below.

There are two common fees payable in relation to the notarization and registration of secured transactions, as follows:

- (a) the notarization fee is levied on the value of secured assets or value stated in secured agreements, but the maximum fee applicable is ten million Vietnam Dong (VND10,000,000)⁹³; and
- (b) the registration fee of each secured transaction is eighty thousand Vietnam Dong (VND80,000). 94

⁹³ Joint Circular No. 08/2012/TTLT-BTC-BTP of the Ministry of Finance and Ministry of Justice dated 19 January 2012 guiding the rates, collection, remittance, management and use of notarization fees - approximately USD500.00 as at the time of publication.

⁹⁴ Joint Circular No. 69/2011/TTLT-BTC-BTP of the Ministry of Finance and Ministry of Justice dated 18 May 2011 guiding the collection, remittance, management and use of registration fees for secured transaction, fees for providing information on secured transaction and fees for usage of regular customer services - approximately USD4.00 as at the time of publication.

4. How long following acquisition of a foreign target company would it usually take in Vietnam for a Vietnamese subsidiary of that foreign target company to grant a guarantee/ security?

A public company may not give a guarantee in favor of its shareholder or related persons. ⁹⁵

A company established in Vietnam may only guarantee an obligation of an offshore entity with approval from the Prime Minister. There is currently no prescribed timeline or procedures for obtaining such an approval from the Prime Minister. We are not aware of any precedent in this specific case, but normally in other cases, to obtain a Prime Minister approval, it may take from a few months to a year. 96

5. Are there any restrictions on foreign banks lending to companies in Vietnam? Are interest payments to foreign banks typically subject to withholding tax?

Lending by foreign banks generally

There are no restrictions on foreign/offshore banks lending to companies in Vietnam if the lending does not involve any onshore credit institution (lenders).

If the lending involves both offshore and onshore lenders in a syndication, under Circular No. 42/2011/TT-NHNN, issued by the State Bank of Vietnam (**SBV**) on 15 December 2011, offshore credit institutions which grant syndicated credit facilities in Vietnam are not permitted to act as syndicated lead lender (facility agent) or payment coordinating member (paying agent) or coordinating member of receiving security assets (security agent). All of these roles must be held by an onshore credit institution.

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⁹⁵ Circular No. 121.

⁹⁶ Circular No. 37/2013/TT-NHNN dated 31 December 2013.



There are certain restrictions applicable to companies established in Vietnam borrowing from overseas entities (e.g., loans from foreign/offshore banks) (offshore loans), as follows.

Offshore loans borrowed by enterprises and economic organizations belonging to the public sector

Offshore loans permitted

Enterprises and economic organizations belonging to the public sector (**State-owned Enterprises**) are permitted to obtain offshore loans directly in the form of independent borrowing and bear responsibility for repayment to the foreign lenders under the conditions and undertakings in the loan agreements.

Government not liable unless guarantees

The Government is not liable for debts arising from offshore loans obtained directly by State-owned Enterprises, except for loans guaranteed by the Government.⁹⁷

Requirements and compliance

All medium-term and long-term foreign commercial loans obtained by State-owned Enterprises must be within the annual overall quota on foreign commercial loans approved by the Prime Minister They must satisfy the conditions on medium-term and long-term loans stipulated by the SBV from time to time Their final draft must be submitted to the SBV for comments and they must be registered at the SBV. There must also be periodic reports made to the SBV on the status of drawdown, capital utilization and loan repayment in accordance with the reporting regime stipulated by the SBV.

If a State-owned Enterprise borrows foreign loan capital by way of the issue of international bonds, it must prepare a plan for the issue and obtain appraisal opinions from the ministry or People's Committee in

⁹⁷ Article 4.4, Decree No. 213/2013/ND-CP on Management of Foreign Loans without Government Guarantee.

charge or the organization that represents the State-owned capital at the enterprise, as the case may be, and submit that plan to the Prime Minister for approval. 98

Drawdowns and transfers of money for repayment of offshore loans by State-owned Enterprises must be made through banks operating in the territory of Vietnam that are authorized to conduct foreign exchange transactions, except for drawdowns to make direct payments to foreign suppliers. If a drawdown or loan repayment in the form of goods or assets (whether the assets are tangible or intangible) is not made through a bank, the enterprise must submit a report under the regulations of the SBV, and where necessary, the opinion of the State administrative body for the relevant industry or sector will be required.

State-owned Enterprises obtaining offshore loans are responsible for using loans for proper purposes, are not be permitted to use short-term loans for investment in long-term or medium-term projects, must make repayments (of both principal and interest) in accordance with undertakings in the loan agreements signed with foreign lenders, and bear all risks and responsibilities during the course of loan drawdown and repayment.

In the case of medium-term and long-term loans of State-owned enterprises, banks are only permitted to make disbursements and transfers of money for loan repayment to foreign lenders where those loans have been registered under the regulations.

The SBV will co-ordinate with the Ministry of Finance to provide detailed guidelines on procedures for control of offshore loans and loan repayment by State-owned enterprises.

Offshore loans guaranteed by the Government will follow separate regulations issued by the Government and the SBV.

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⁹⁸ Article 26, Decree No. 90/2011/ND-CP on Issuance of Corporate Bonds (**Decree No. 90**).



Offshore loans borrowed by enterprises and economic organizations belonging to the private sector

All offshore loans borrowed by enterprises and economic organizations belonging to the private sector (**Private Enterprises**) are subject to supervision and monitoring by the Government. The SBV is the body representing the Government in the exercise of its supervision and monitoring functions.

Private Enterprises must register loans with the SBV after signing a loan agreement with a foreign lender and must implement the reporting regime stipulated by the Governor of the SBV.

Private Enterprises utilizing foreign loan capital are fully liable for repayments under the undertakings in loan agreements, the laws of Vietnam and international practice in law.

In the case of long-term and medium-term loans by Private Enterprises, domestic banks are permitted to make disbursements and transfers of money only for loan repayment to foreign lenders where those loans have been registered under the regulations.

Where an enterprise other than a State-owned commercial bank or a State-owned enterprise issues international bonds, under Circular No. 17/2013/TT-NHNN, it must open and use accounts for foreign borrowing and repayment at a credit institution to issue those bonds. Also, after the issuance plan is prepared and approved in accordance with Article 24 of Decree No. 90, the enterprise must send a dossier requesting confirmation of the limit of international bond issuance to the SBV (i.e., a confirmation by the SBV that the issuance is within the annual commercial loan quota approved by the Government).

Offshore loan registration

Medium-term and long-term offshore loans (i.e., the loan term is more than one year) must be registered with the SBV within 30 working days from the date of the signing of the loan agreement and before a drawdown

In the case of the extension of a short-term loan where the total duration of the original short-term loan plus the extension is more than one year, the enterprise must conduct registration with the SBV within 30 working days from the date of signing of the contract for extension.

If there are any changes in the details of the offshore loans that have been registered by the SBV, re-registration of those details with the SBV must be completed.

Loan drawdown and repayment

The drawdown and repayment of offshore loans of enterprises may be carried out only through one authorized bank, except for the following transactions (where the authorized bank does not provide guarantees or services):

- (a) drawdowns for direct payment to foreign beneficiaries in relation to imported goods and services;
- (b) drawdowns and debt repayment through accounts of enterprises opened overseas (where enterprises are permitted to open overseas accounts); and
- (c) drawdowns in the form of import of goods and services with deferred payment and debt repayment in the form of export of goods and services.

Where enterprises are carrying out drawdowns and debt repayment through one authorized bank but wish to work with another authorized bank, they must finalize the transactions of drawdown and debt repayment at the former bank. In the case of medium-term and long-term loans, enterprises must register with the SBV the change of authorized bank to provide the services of drawdown and debt repayment.

Withholding tax

Interest payments to foreign banks are subject to withholding tax.



The current tax rate is 5% per the amounts paid to foreign banks (under Article 11.3.e Decree No. 218/2013/ND-CP and Article 13.2 of Circular No. 60/2012/TT-BTC).

6. If a takeover bid, which relies on bank debt, is made for a publicly listed company in Vietnam, what requirements regulate the certainty of the availability of that bank debt when the deal closes?

Vietnamese law does not have any specific provisions in relation to the availability of bank debt when a takeover bid is made for a publicly listed company.

7. What is the order of priority on insolvent liquidation? Are debt holders given priority over equity holders by law?

Where the Court has decided to commence liquidation procedures, funds will be distributed in the following order of priority:⁹⁹

- (a) fees and costs of the bankruptcy proceedings;
- (b) unpaid wages, and the like, to employees;
- (c) unsecured debts payable to the creditors, according to the ratio of debts owed; and
- (d) if funds remain after the above distributions, they will be owned by the owners' partners, shareholders or members of the enterprise or co-operative.

Therefore, debt holders are given priority over equity holders by law in terms of payment on insolvency of the company.

Secured debts are not included in the priority order. Secured debts are recovered in priority from the relevant security. If, however, the

⁹⁹ Article 37 of the Law on Bankruptcy.

security is not enough to recover the debts, the remaining part of the debts will become unsecured debts. 100

8. Is interest on debt incurred to acquire a company in Vietnam deductible from earnings for tax purposes? Are there any thin capitalization thresholds?

If the funds that a share purchaser borrows from a third party to finance its acquisition of a company in Vietnam is made in a foreign country (i.e., the country of the purchaser) this loan would not be related to the local target company as this is a transaction conducted outside Vietnam between offshore entities. As such, there would be no Vietnamese tax implication on the interest incurred.

There used to be a thin capitalization rule for foreign-invested companies. Under the former Law on Foreign Investment, now repealed, the minimum legal capital (now referred to as the charter capital under the current law) was 30% of the investment capital. The current Enterprise Law and Investment Law now have no requirement on the minimum percentage or amount of charter capital (except for certain special industries such as insurance, banking or real estate, etc., where the law sets out the required minimum amount of charter capital). However, late contribution of charter capital will lead to non-deductibility of loan interest expense to some extent, as discussed further below.

Interest expense for loan capital payable to credit institutions is fully deductible if:

- (a) the loans are properly supported by loan agreements;
- (b) the interest payment is based on the interest rates in the loan agreements; and
- (c) offshore medium-term and long-term loan agreements are duly registered with the SBV.

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¹⁰⁰ Article 35 of the Law on Bankruptcy.



Tax law, however, provides that interest payments are not deductible where "interest payments [are] for loans used to contribute charter capital or interest payments [are] for loans corresponding with the shortage of the registered charter capital even in the case [where] business establishments have been in business operations." ¹⁰¹

Therefore, if the charter capital, which is supposed to be the investor's equity, is funded by loans, the loan interest expense will not be deductible. Similarly, if the contribution of the charter capital is behind the committed schedule, the interest expense for the loan amount corresponding to the shortage of the charter capital will not be deductible.

For example, an investor commits to contributing USD5 million of charter capital within six months after the issuance of the Investment Certificate, but in fact, contributes only USD4 million of charter capital within the six-month period. In this same period, the company borrows USD3 million. The interest expense in relation to USD1 million that was not actually contributed will not be tax-deductible, as it is deemed to be interest expense in relation to the US 3 million loan amount which was borrowed (at least in relation to US 1 million) to cover the shortage of the committed charter capital.

9. Will contractual subordination be honored by a liquidator or bankruptcy trustee in Vietnam?

Under Vietnamese law, secured debts and obligations have a priority right to payment by secured assets, and non-secured debts. 102 Vietnamese law does not have the concept of subordination. Therefore any subordination agreement will be on a contractual basis only. The bankruptcy court will treat all non-secured debts on a pari passu basis.

¹⁰¹ Decree No. 218/2013/ND-CP dated 26 December 2013 of the Government - Article 9.2.e and Circular No. 123/2012/ T T-BTC dated 27 July 2012 of the Ministry of Finance regarding Enterprise Income Tax – Article 6.2.16.

¹⁰² Articles 35 and 37(1)(c) of the Law on Bankruptcy.

The law stipulates that debts of the dissolved enterprise must be paid according to the order set out in the answer to question 7 above. ¹⁰³

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 $^{^{103}}$ Article 158(4) of the Law on Enterprise and Article 37 of the Law on Bankruptcy.

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