Zafo Law

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Factsheet

Governing body's responsibility for de facto closure of a company

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According to Spanish legislation, when a company ceases to be viable or when shareholders decide not to continue with the company's activity, the governing body of the company has the obligation to wind up the company or, if the company is insolvent, to submit it for judicial bankruptcy.

De facto closure of a company

In Spain it is very usual to find companies without carrying out an activity, being impossible to get in contact with them, as they do not have employees, an office, telephone, an active e-mail, etc. Those companies keep being registered within the Mercantile Registry and within the Spanish Authorities.

Sometimes shareholders decide not to continue with the activity. They do not wish to spend money winding legally up the company (lawyer, notary, mercantile registry) and deregistering the company before Spanish Authorities or other entities. They just let the company *"to go into a coma"*, and the governing body of the company (in most of the cases also shareholders) decides to stop managing the company, without taking into consideration its legal obligations and without thinking of the consequences that this can lead to, principally if there are creditors.

Spanish legislation (art. 363.1.a of Corporate Law) establishes as one of the legal causes for winding up a company, the cessation of the activity, understanding as such period of inactivity of more than one year. That means, at the governing body must proceed with the winding up of the company or with bankruptcy process, if the company is insolvent. This is compulsory by law to protect creditors, giving them the possibility to negotiate and obtain the payment of their credits, in full or in part.

The facto closure of a company without following the legal norms can lead to damages to third parties and creditors.

To not deregister obligations before authorities: Tax and Social Security

Companies that are *de facto* closed, without winding them up, can inactivate the activity before Tax Authorities, but they still have some obligations as for instance submit annual accounts and corporate taxes yearly. The only way to deregister totally a company before Tax Authorities is with the legal winding up of it.

Failure to comply with these obligations can result in closure of registry, imposition of administrative sanctions, the revocation of the tax-number and may also lead to liability for the governing body of the company.

It can happen, that the governing body of the company consists of one or two administrators, that must be registered within the Spanish social security, expressly when there are no employees. As soon as the company gets *de facto* closed, they decide stop paying the social security contribution without unsubscribe the company before the social security, although the company from a legal point of view exists and the obligations to contribute too.

Failure to communicate the inactivity of the company constitutes a serious infringement.

De facto or de jure directors (board of directors) may be held vicariously liable for tax debts and, in certain cases, for the penalties imposed on the company, provided that at least negligent conduct is proven, either by action or omission, in the fulfilment of their obligations. Liability is not objective, and the Administration must motivate and prove the conduct attributable to the director, applying the principle *in dubio pro reo* in case of doubt. This is established in Article 43 of the General Tax Law 58/2003, of 17 December.

There are some exceptions regarding the obligation to be registered within the Spanish social security, as for instance that the administrator lives in another country and can prove that he is paying social security contribution in his own country, but some formal requirements must be met.

For the derivation of Social Security debts to proceed, the following requirements must be met: a) existence of a claim against the company; b) concurrence of legal cause for dissolution; c) failure of the administrator to comply with his legal obligations. The liability extends to all Social Security debts (fees, surcharges, interest and costs) generated after the cause of dissolution and during the period in which the administrator holds the position. The administrator may be exonerated if he proves that the debt is prior to the cause of dissolution or if he complied with his legal obligations (call for a meeting, request for bankruptcy, etc.) on time. The legal presumption favours the creditor, shifting the burden of proving that the debt predates the cause of dissolution to the administrator.

The declaration of liability of the company's directors does not require a prior pronouncement by the civil jurisdiction, but the Social Security itself issues a communication of said derivation of liability (administrative step).

Governing Body's responsibility

To close *de facto* a company does not lead automatically to the governing body's responsibility. It is necessary that creditors claim against the company and against the governing body of it.

Creditors must prove following requirements to claim against the governing body when *de facto* closing a company:

- Unlawful behaviour of the governing body: that means to avoid the legally winding up of the company and the cancelation before authorities.
- Direct financial damage to third parties: not payment of creditors' credits.
- Direct causal relationship between the unlawful behaviour and the damage: it is not enough to prove the *de facto* closure, but it is necessary to prove that if the legal winding up of the company had been carried out, it would have been possible, for the creditor, to collect his credit, in whole or in part, as for instance proving that at the time the debt was claimed, the company was still operational although with financial difficulties.

In the other hand, the governing body must prove the company's financial position at any time.

Authorities can also claim against the governing body for not proceeding with the legal winding up of the company and not comply with the obligations of submitting annual accounts, corporate taxes or social security contributions.

Parent company as *de facto* administrator

It is important to be aware that companies with a sole shareholder can be considered as *de facto* administrator for the Spanish subsidiary and responsible for the *de facto* closure of the company, if following requirements are met:

- The parent company carries out the effective, autonomous and continuous management of administrative functions, i.e. organisation, direction (in technical, productive, commercial, financial fields).
- Displacement of the power of management from the governing body of the Spanish company, i.e. exercising the power of management in a sovereign and independent manner.
- Existence of damage (no-payment of credits)
- Causal relationship between the conduct (closure de facto) and the damage, particularly if there were sufficient assets in the company at the time of the closure.

This can be understood, specifically when the governing body of the Spanish company matches with the governing body of the parent company.

Conclusion

Before stopping the activity of a company and try to let it die, it is very important to review all the agreements and obligations and try to come into an agreement with creditors (i.e. leasing agreement, rental agreement of premises, commercial debts, etc.). Then it is possible to wind up the company in a legal and appropriate form.

If the shareholder does not wish to wind up the company following the legislation or the governing body does not wish to submit the company to a bankruptcy judicial proceeding (in case of insolvency), because

they believe that they will continue with the activity in a future, and decide to register the company as inactive before tax authorities, it is important to remember that there are some obligations to be complied with authorities, as to submit annual accounts and corporate taxes yearly, unsubscribe the company within social security.

If the company does not come into an agreement with creditors, apart from the company, the governing body of the company (and in some cases the sole shareholder) can be declared responsible for not complying with the company's obligations, which means that they will be liable with their private assets.

Zafo covers all of Spain

From our offices in Barcelona and Alicante, we cover the whole of Spain. By this, we mean that we also offer our help in Madrid, Málaga and Mallorca, among other places.

In fact, this has been the case ever since we opened our fist office in Barcelona in 2004 and has since only been reinforced by the opening of additional offices in Alicante in 2006.

We have therefore also gained a lot of experience of the differences and similarities that exist between the different Spanish autonomies in relation to the issues faced not only by our clients, but also in relation to the demands raised to our company, Zafo Law, by the authorities of the different Spanish regions from which we have been operating.

What is compulsory in one autonomy is not necessarily in another, and this contributes greatly to making Spain as a complex country, for better or worse.