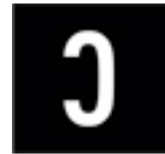

Contraditório Think Tank

Article

Long term purchase of property with a "SABP" | Ursula M. Hahn

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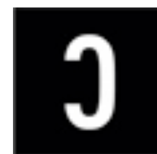
"SABP" – the history

The Portuguese legislation has amended the country's company structures and their tax assessments over the years. Red tape was eliminated with the creation of the "Empresa na Hora" which allows for an uncomplicated incorporation of a company within hours, with instant registration in the Company Register (RNPC) and the Social Security system. This part of the Simplex reforms should make other countries envious.

Another Portuguese company form, the "SABP - Sociedade de Simples Administração de Bens Próprios", regulated in the **Civil Code, art. 980 – 1021**, has remained untouched by change for a long time. Dennis Swing Greene from Eurofinesco S.A., a leading tax service for foreigners in Portugal: "Although infrequently used in recent years, Civil Companies have existed in Portuguese statute law since the 19th century and have been embraced in subsequent legislative reforms over the past 150 years."

Why is that, you may ask? The fabric of the Portuguese society is based on large families; land and real estate have traditionally been the most valued possessions for a family. Landed owners often faced the problem of distributing monies and property fairly between offspring with diverse careers: sons used to enter the military or the church; girls went to marry outside of the family or needed a good dowry for a convent. Inheritance was another crucial point in time for a family handing over property to the next generation.

In order to keep the property under family control, the SABP was created. The structure proved valuable to achieve the means of keeping wealth together,



therefore the legislature, mindful of the interest of influential families, did not change the basics until today. Especially in terms of taxation, the structure is interesting because it provides several tax benefits, we shall only mention a few of them.

SABP – the structure

A "Sociedade de Simples Administração de Bens Próprios" is a non-trading entity, held by two to five shareholders, usually family members. An administrator needs to be appointed who takes care of reporting and other compliance obligations.

The company, without any commercial activity, is tax exempt (no PEC applies here) but reports all activity to the Finance Authority. Profits, for example from rentals of a property held within the structure, are assessed to the shareholders who can enter into a loan contract with the SABP ("Contrato de Comodato"). Property held with the company is usually real estate but a portfolio can also be managed. English-speaking readers may be reminded of a Trust, indeed, the SABP proffers a similar structure.

The SABP turns immovable property into movable property - shares - with a low capital gains tax in the event of a sale. Another upside is the ease of transfer. A property sale entails costs for lawyers, a notary and taxes, whereas a share can be transferred with a simple deed of sale.

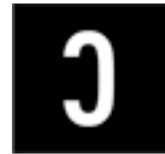
An example – two partners

Let us examine a situation in which the Sociedade can be used for this purpose. An example:

We have a seller – let's call him **Sam** - who is interested to sell a surplus property (not his main residence). Sam might also be a property developer with several units to sell. In this time of crisis, he faces a stagnant market with depressed prices. Persons interested buying his property have little chance to obtain a mortgage; The banks are in the process of consolidating their portfolios; interest rates are low and small mortgages are not turning good profit. The result: Sam has no buyer, no sale, no revenue.

On the other side is **Henry**, a family man with a secure income, who would like to buy the property Sam offers but, even with a good credit rating, he has difficulties in obtaining a mortgage.

Between these parties, we place a *mediator*, for example a notary, law firm or



tax advisor. This entity - let's call the firm **Winter** – draws up a contract between the two parties where both declare to create a Sociedade for the purpose of the long term transfer of the property from Sam to Henry.

The setup of the contract

<u>The steps that need to be taken:</u>

First Winter organizes an independent survey to assess the actual value of the property and checks the VPT (Valor Patrimonial), the *official value* the property has at this time with the AT (Tax Office) - this value will be important by the end of the contract. Based on the *market value*, the parties agree on a time frame, value per share and monthly or quarterly payments from Henry to Sam. Step by step, Henry will pay and receive more shares each month or quarter, until by the end of the contract, he has 100% of the shares in his hand.

Winter will set up a contract to cover the process, based on the conditions the two parties agree between each other. This document is similar to a Promissory Contract.

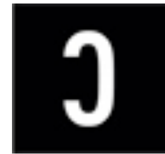
Let's say Sam will buy a T1 from Henry for the current market price of 120.000 euro. To be on the safe side, he envisions that he can pay this amount within 15 years, the monthly rate will be roughly 667 euro. (He will not pay interest, only capital).

Both parties need to negotiate the following terms:

1. Option A: Sam and Henry share the **cost of the company incorporation**, charged by Winter 50/50, as well as the **annual maintenance costs** until the contract is finished;
2. Option B: both share the cost of the incorporation 50/50 and Henry assumes the annual fee once the 50/50 threshold is reached.

The parties also need to set up the **shareholders**; the law requires a minimum of two and a maximum of five. In this case, both Sam and Henry are shareholders but their spouses may also enter into the contract. From the beginning, Sam will hold a small "*golden share*", and Henry will have all shares, except this *golden share,* in his favor.

The amount of the sale of €120.000 – supported by the independent survey - determines the **time frame** so that Henry will be able to manage the payments without problems. In this case both opt for a 15 year contract with monthly payments.



With the incorporation, Henry pays for and receives one minimum *golden share* with the value of 1%.

Sam and Henry also negotiate a **down payment** of 10% which has to be paid up by Henry. *Without a down payment, the deal would not be attractive to Sam.*

The number of **shares** is equivalent to the number of payments (99%) plus one share of 1%.

Total sale price	€120.000,00	200 shares
1% *golden share* for the incorporation	€1.200,00	2 shares
Deposit of 10% minus *golden share*	€10.800,00	18 shares
Rest to be paid over 15 years	€108.000,00	180 shares
Per year	€7.200,00	
Per month	€600,00	

The parties also need to agree on the **provisions for a final payment** to make up for the changes in market value, inflation and VPT (see chapter “At the end of the contract”**).**

Startup

With these data, Winter establishes the contract, and incorporates the company.

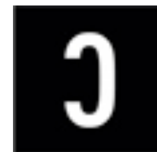
In the second step, Sam’s property is transferred by Winter into the Sociedade. This act triggers **stamp duty and IMT**, the parties need to determine if this is paid by Henry or shared by both.

Winter is administrator and holds the shares in escrow for both parties.

Once Henry has paid for his *golden share* and has made the down payment in the form of 18 shares, he receives the keys to the property. *This is not a transfer of ownership but a right of occupancy. It does not constitute a rental contract, either; Henry does not have protection of the respective legislation. If he stopped the payments, he would be committing fraud.*

During the duration of the contract

Over the next 15 years, the monthly payments from Henry are sent to an escrow account in Sam’s name under the tutelage of Winter which supervises the transfers of shares from Sam to Henry. Sam now has a regular income from a property that



otherwise would be stuck in his portfolio without generating any revenue.

After 7.5 years, Henry holds the majority of shares but Sam is, as shareholder, still in control of the property.

During the whole duration of the contract Henry who has the use of the property, pays the annual **IMI** property tax via Winter. Failure on his part to pay taxes or fees in advance would trigger a halt of share transfers.

During the duration of the contract, Henry is in charge **of maintenance, renovations and capital improvements** as all of these investments will be to his advantage. He decides what to implement and he is responsible for the payment. Capital improvements result in an increase of shares; Winter adds them to Henry's portfolio.

Henry has, at all times, the right to buy the remaining shares and get hold of the ownership.

Problem solving

As in any long term contract, problems may occur, for instance if one of the parties faces financial difficulties. All eventualities must be addressed in the contract from the start.

In case of insolvency

By Sam: Sam's shares have to be turned over to his creditors but they cannot get control of the property - Henry is partially in control (*golden share* and shares already transferred) and has the option to buy all shares at this time.

By Henry: Henry's shares have to be turned over to his creditors but they cannot get control of the property - Sam is still partially in control and has the option to buy all shares at this time.

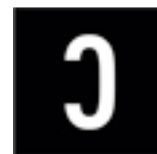
If one of the partners wants to terminate the contract before the completion date:

In this case the rules that are applied to a Promissory contract are easy to apply.

If Sam wants his property and Usufruct back he has to pay to Henry twice the amount of the shares he handed over so far.

If Henry wants to terminate the contract:

1. Henry has to offer his shares at market value to Sam first;



2. After a waiting period, he can sell to third parties who are obliged to enter into and abide by the **contract** and continue to buy the shares;
3. Or he forfeits everything he paid so far;
4. He has to vacate the property immediately, otherwise he commits fraud.

At the end of the contract

Nobody has a fully functioning crystal ball...

After the duration of 15 years, the market value for the property may have increased – Sam might be unhappy that he receives, in total, a lower amount than he could have gained, had he sold later. If the market value of the T1 is now lower than €120.000, Henry may be piqued that he has to pay more for the apartment than he would have paid, had he waited and got a new deal with another property.

Both parties should be satisfied with their deal in the end.

In order to achieve this, Winter will:

1. Order a new independent property survey;
2. Determine the inflation rate over the course of the 15 years;
3. Obtain the current VPT from the AT.

Based on this, there will be an amendment to the price of €120.000

The final extra amount to be paid from (most likely) Henry to Sam will be based on three values:

1. The deviation between the old and the new market value;
2. The inflation coefficient incurred during the duration of the contract;
3. The new (or unchanged) official VPT (which is always lower than the market value and does not fluctuate as much).

The difference between the old and the new market value may be great or small. In any case, only a fraction of the difference should be applied to a final payment. Both parties have benefited from the agreement since 15 years, and a too large final payment from one party to the other might endanger a satisfying end of the deal. Therefore the parties accept in the beginning that, for example, only 10% of the difference between the old and the new market value will be applied to their case.

To this figure, the other two coefficients, also with a fractional percentage, are added.

An example with **increased** market value:

Old market value	€120.000,00	New market value	€140.000,00
Difference	€20.000,00	Percentage 10%	€2.000,00
Inflation over 15 years	+4,50% on €120.000,00	Percentage 10%	€540,00
VPT change	+0,2% on €120.000		€240,00
Total	Henry pays to Sam an additional		€2.780,00

An example with **decreased** market value:

Old market value	€120.000,00	New market value	€100.000,00
Difference	€-20.000,00	Percentage 10%	€-2.000,00
Inflation over 15 years	+4,50% on €120.000,00	Percentage 10%	€540,00
VPT change	-0,2% on €120.000		€-240,00
Total	Sam pays Henry back		€1,220,00

The inflation coefficient will most likely increase the value. The VPT may have stayed the same, may have increased (for instance by the *capital improvements made by Henry*) or may have decreased.

The application of percentages on these amounts means that Henry can rest assured that the final payment will not overwhelm his financial means. Sam knows he will most likely get a small compensation if there is an increased market value and inflation.

Advantages and the drawbacks of this solution

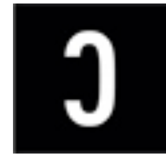
What are the advantages and the drawbacks of this solution?

<u>The advantages for Sam:</u>

He has a regular income from a property which otherwise would not bring any revenue;

The shares he holds can be used as collateral;

His Capital Gains Tax is reduced to 14%.



The drawbacks for Sam:

He has to wait until he receives the final payment;

The initial sales price will only be adapted in a small degree to the final market value;

He needs to pay part of the cost for the company incorporation and the annual fees.

Advantages for Henry:

He can move into the property after the down payment;

He pays fixed amounts which are based on the property's market value from the start of the contract;

He can be certain of the date when the property is his 100%;

He needs no mortgage and pays no interest;

His shares can be used as collateral.

The drawbacks for Henry

He needs to pay part of the cost for the company incorporation and the annual fees.

Note:

A Portuguese "Sociedade" can hold property in other countries which do not have a similar structure . This would be very interesting for Spain. In this case the contract would have to abide by Spanish law, but the company would be Portuguese; extra costs would be incurred with certified translations, Apostile costs etc.

Ursula M. Hahn, Associate Researcher at Contraditório Think Tank

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