Is the exercise of a lien on shares (im)possible?

Prepared by AmCham member

Since 1 October 2012, shareholders in limited liability companies have had a new obligation. Slovak natural and legal persons must file a consent form from the tax administrator when registering transfers of majority shares with the Company Register. Consent can only be obtained by persons with no tax arrears. This is meant to prevent excessive VAT deductions and improve payment discipline on the part of Slovak natural and legal persons. The duty does not apply to foreign persons.

This article analyzes the problems which banks as security holders face when exercising their rights under a security agreement that establishes a lien on shares in limited liability companies.

When providing a loan, repayment security is vital for the lender. The bank or other financing institution wants to ensure fulfillment of the borrower's obligations to the maximum, usually by creating a lien on the borrower's property. A lien on real estate must be registered in the cadaster. A lien on movable property (such as machinery) and claims must be registered in the Notary's central register of pledges.

A lien on a borrower company's shares must be registered with the Company Register (the agreement creating a lien is entered into between the bank as lien holder and the shareholders in the borrower company). If the borrower fails to repay, the bank as security holder is authorized by law to satisfy its claims from the collateral. This means that the bank is free to sell individual parts of the borrower's property until the claim is satisfied to the full extent. Thus, the bank can sell real estate and movable property, collect claims, and sell shares in the borrower company. During these activities, the bank acts by law on behalf of the person that provided the bank with the security interest.

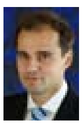
When exercising the rights under the agreement that establishes a lien on shares, the shares are sold, i.e., transferred. According to legal regulations valid before 30 September 2012, share transfers were not limited by the state (unless the transfer was prohibited by the Memorandum of Association/Deed of Foundation), and registration of a share transfer with the Company Register was a mere formality, with the transfer coming into force even before registration. However, Amendment No. 246/2012 to the Commercial Code introduced several new provisions mainly concerning the transfer of majority shares in limited liability companies owned by Slovak natural and legal persons (a majority share according to law is a share representing at least 50% of all shareholder votes).

When exercising a lien on shares, lien holders may suffer administrative burdens and further costs if shareholders owe tax arrears, or if the company refuses to cooperate with the lien holders.

The most important change is that the transfer of a majority share is effective only on registration with the Company Register. The applicant must simultaneously file the consent form of the tax administrator with the Company Register. The tax administrator will not give consent if either the transferor or acquirer of the shares owes tax arrears exceeding EUR 170. And herein lies the problem. If, during preparation for registration of the transfer with the Company Register, it appears that the shareholder owes tax arrears exceeding EUR 170, (i) the tax administrator will not consent to the transfer, and, therefore, (ii) the Company Register will not register the share transfer. The transfer then will not come into force, and the lien holder´s rights cannot be effectively exercised. It is also interesting to note that the lien holder cannot apply to register the share transfer with the Company Register even if it obtains the consent of the tax administrator, as only the company's directors can file the application. However, we emphasize again that the above only applies to transfers of majority shares of Slovak natural and legal persons.

Although the consent of the tax administrator is not required for the transfer of shares owned by foreign persons, the bank as lien holder must file a written declaration by the foreign person-shareholder that the obligation to file consent does not apply. Without the company director's cooperation, the bank's claim will not be satisfied by way of executing a lien on the shares in the company. A lien on share will then become meaningless for the bank.

Whether increased tax controls and administrative burdens on the registration of transfers of majority shares of Slovak natural and legal persons with the Company Register will have an effect on tax fraud remains to be seen. This article has analyzed the issue from the point of view of lenders as they will suffer administrative burdens and further costs if the shareholder owes tax arrears, or if the company refuses to cooperate with the lien holder.



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