

# The process of selling real estate to tenant-owned associations

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## Introduction

The purpose of this essay is to describe in summary the process of selling a property to a tenant-owned association once it has been decided that the property will be sold. The procedures in the process before this step will not be discussed in this essay. This essay relates to Swedish laws and practice and is written from a seller's perspective.

## Choice of transaction type

Once it has been decided that the property will be sold to a tenant-owned association there are different options regarding how to sell it. Either it could be sold directly from the present owner to the tenant-owned association, or it could be sold in a company deal. The fact of crucial importance is that profit from sales of properties is subject to tax, whereas profit from sales of shares in this type of transaction is not. One should bare in mind that this rule applies to the Swedish type of company called AB. Profit from sales of shares in companies of the types HB or KB is still subject to tax.

A company deal is more complex and often results in higher transaction costs. When choosing which transaction type to use one way to do it is to compare the lower tax cost to the higher transaction costs. Since it is usually more favorable to sell the property in a company deal this type of transaction will be described in the essay. The transaction is usually divided in the following steps:

- Step 1: Selling the property to a dormant company
- Step 2: Selling the company to the tenant-owned association
- Step 3: Transferring the property to the tenant-owned association
- Step 4: Liquidating the company

The steps will be described in detail in the following sections.

## **Selling the property to another company**

One of the first things to do when selling a property from one company to another company within the group is to set the price. Since the profit from sales of properties is subject to tax the price should not be set too high. If the price is lower than the market price the transaction is considered an under-value transaction and then there are three conditions that must be fulfilled.

First of all, the buyer or the seller must not be of the company type HB or KB. Since April 18<sup>th</sup>, 2008, it is not allowed to do any under-value transactions from or to companies that are a HB or a KB. Consequently, the price must be set at market price or higher.

Furthermore, if the seller cannot leave group contribution to the buyer during the financial year the transaction is completed, it must be a so-called line of business that is transferred. Group contribution means that profit and losses can be leveled out within a group. A subsidiary must be owned by at least 90 % by the parent company. A company must have been part of the group during the whole financial year to be able to leave or receive group contribution. In order to carry out the under-value transaction a property must be considered a line of business. According to legal practice and different statements from authorities a separate property is usually considered to be a line of business. This applies as long as the property generates revenues to a significant extent.

Another condition that must be fulfilled is that there must not be a deficit within the company that buys the company, nor in a company that the buyer could leave group contribution to during the financial year the transaction is completed. It is the deficits that were reported at the previous financial year that are of interest. An exception from this rule is when the seller can leave group contribution to the buyer during the financial year the transaction is completed. Since the buying company in most situations is sold after the property has been transferred, this is often not the case.

If the purchase price is lower than the tax value of the property in an under-value transaction, the transaction must be treated in the tax statement as if the price equaled the tax value.<sup>1</sup> With this fact in mind, it does not make any sense to set the purchase price lower than the tax value. As a result the price for the property in an under-valued transaction is usually the same as the tax value,

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<sup>1</sup> Inkomstskattelagen (1999:1229), 23 kap

which means that there will be no taxable profit on the transaction. Since the book value usually is higher than the tax value, due to for example higher depreciation rates, there is usually a loss in the accounting on the item “Profit from sales of properties”.

In order to sell the property to another company there are a few documents that must be drawn up:

- *The purchase contract* shows the terms of the agreement between the parties. It must contain the purchase price and a declaration from the seller that the property is transferred to the buyer. Usually the contract also contains details like the acquisition date, the distribution of the result, which of the parties is responsible to pay the stamp duty and so on. The purchase contract must be signed by the seller and the buyer.
- *Bill of sale* could be considered a receipt that the transaction has been completed. Sometimes there are conditions set in the purchase contract that must be fulfilled for the purchase to be completed. The bill of sale is a proof that the conditions are fulfilled and the transaction has been completed.<sup>2</sup>

An application for the entry in the land register must be carried out within 3 months from the acquisition date. When a property changes owner, stamp duty must be paid according to law. The stamp duty is 3 % of the purchase price for a legal person while other persons, including tenant-owned associations, only pay 1.5 %. If the tax assessment value is higher than the purchase price the stamp duty is calculated on that amount instead. In the case when the purchase price is lower than 85 % of the tax assessment value the acquisition is considered to be a gift and no stamp duty has to be paid. If the seller and buyer is part of the same group the buyer has a possibility to get respite for the payment of the stamp duty. As soon as the company is not part of the group anymore, the stamp duty must be paid.<sup>3</sup>

According to law it is compulsory to report the acquisition of a property with apartment buildings to the municipality and to get a license to acquire the property from the regional rent tribunal. The acquisition must be reported to the municipality within 3 months from the acquisition date. The municipality gives the regional rent tribunal the possibility to comment on the application. The municipality can demand for a trial of the acquisition within 4 months from the day the application was sent to the municipality. If the acquisition is not reported in the right time, it is not valid. It is not necessary to report the

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<sup>2</sup> Jordabalken (1970:994), 4 kap

<sup>3</sup> Lagen om stämpelskatt vid inskrivningsmyndigheter (1984:404)

acquisition to the municipality or to get a license from the regional rent tribunal if the property is acquired by a tenant-owned association.

The buyer can get permission from the regional rent tribunal before the acquisition date without first applying to the municipality. The municipality cannot request a trial in that case. With these facts in mind it is a good idea to get a license beforehand to prevent anything getting in the way of the transaction.<sup>4</sup>

The municipality has according to law a pre-emptive right to acquire a property if it needs it for different reasons, for example to prevent all properties to become summer houses in a certain region, to provide for future needs of housing or sport facilities etc. The pre-emptive right means that the municipality can acquire the property on the same terms as has been agreed upon between the seller and the buyer if it chooses to use this option. The option must be called upon within 3 months from the day the buyer has applied for an entry in the land register at the registration authority. If the municipality chooses not to use the option or do not apply for it, then the option is lost.<sup>5</sup>

If the seller has registered the property for voluntary VAT liability and the new owner does not have any intentions of changing the use of the property, the VAT liability can be transferred to the new owner. In order to transfer the voluntary VAT liability the seller and the buyer must send an application to the tax authorities separately. In case the buyer has not been registered for VAT before a separate application must be sent to the tax authorities. If VAT has been claimed for investments during the previous ten years the seller shall hand over a document, which shows details of the investments, total VAT for the investments and claimed VAT for the investments. If there are any changes in the use of the property that relate to the investment, the new owner might have to pay back some of the VAT or have the possibility to claim more VAT.<sup>6</sup>

In most cases the property is pledged to a bank as a security for a loan. The security is usually a mortgage deed, which is a certificate that the property owner has raised a mortgage on the property. The stamp duty for raising a mortgage is 2 % of the nominal amount on the mortgage deed. The mortgage deed will always follow the property unless it is either deleted or moved to another property. It can easily be moved between properties that have the same owner and belong to the same registration authority. As properties can also be sold between companies, it

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<sup>4</sup> Lagen om förvärv av hyresfastighet (1975:1132)

<sup>5</sup> Föroöpslagen (1967:868)

<sup>6</sup> Mervärdesskattelagen (1994:200), 8a kap

is possible to move mortgage deeds between companies; in this case the cost will be somewhat higher. When the property is sold, the former owner must either repay the loan or replace the mortgage deed with another security. Since there is a cost when raising a mortgage deed it should be considered an asset that should be paid for when traded.<sup>7</sup>

## **Selling the company to a tenant-owned association**

It is recommended that the property is owned by the company for at least 2 weeks. The reason for this is that it looks better if the company has generated a result and not only transactions from buying and selling a property. As revenues and costs are usually calculated and invoiced per month it is often easier if the property is acquired one month before the shares of the company are sold.

In this part of the transaction a purchase contract for the shares must be drawn up. The contract usually contains the acquisition date, details of the actions that will take place on the acquisition date, guarantees and obligations of the parties. An essential part of the contract is the mentioning of the purchase price and the calculation of the purchase price. When setting a price on the shares of a company it is the company's equity, the difference between the assets and liabilities, which is the basis for the price. The main asset, the property, is adjusted to market value which makes the difference between the assets and liabilities bigger and the purchase price higher. There could also be other adjustments, like reductions due to required maintenance on the property or for deferred tax.

On the acquisition date a preliminary price is paid based upon a preliminary balance sheet. It is often attached to the contract. The preliminary balance sheet usually does not show the actual financial situation of the company on the acquisition date. The values in the balance sheet are estimated and not in detail.

The seller has a period of time to report an actual balance sheet of the company to the buyer. The buyer then has a period of time to comment on the balance sheet. If there are comments on the balance sheet that both parties agree must be change, the buyer get a new balance sheet after the changes have been done. If the buyer does not leave any comments on the balance sheet within the set time, it is considered as if the balance sheet has been approved. After the final balance sheet has been approved the sales price is recalculated with the actual balance sheet as basis. If the new sales price is higher than the preliminary price

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<sup>7</sup> Jordabalken (1970:994), 6 kap

the buyer must pay an additional purchase price. If the conditions are the opposite the seller must pay the difference in the prices to the buyer. The final balance sheet is usually more detailed.

When a company buys a property the acquisition is usually financed by a loan, sometimes it is financed by a bank loan. The new owner could, if the seller approves, take over the bank loan. In most cases the loan is repaid on the acquisition date and the new owner find another way of financing. In other cases the acquisition is financed by a loan from a group company. When the company is sold that loan shall be repaid.

If the company has issued a share certificate the transfer of the shares to the new owner must be recorded on it and handed over to the new owner. The transfer of shares must also be registered in the share register. The new owner shall organize a shareholder's meeting, where a new Board and a new auditor are appointed. The changes shall be registered at Swedish Companies Registration Office. The new owner takes over the control and the responsibilities over the company and has a right to get all the material concerning the company.

## **Transfer of the property to the tenant-owned association**

In order for the tenant-owned association to function the property must be transferred to the tenant-owned association. As described above stamp duty must be paid if a property changes owner. There is an exception to this rule if the property is sold to another party without any changes or additions in the terms except for acquisition date and payment. In this situation stamp duty only needs to be paid for the last transaction and in this case only 1.5 % of the purchase price. The application for the entry in the land register must be accomplished within 3 months from the acquisition date of the first transaction. The transfer of the property is usually done on the same day as the acquisition date for the shares. No license for acquiring the property is needed from the regional rent tribunal. The same procedures concerning the VAT registration and documentation must be carried through as when the property was sold in the first step.

## **Liquidation of the company**

When the property has been transferred to the tenant-owned association the company that bought the property in the first step is dormant. Since it takes time and money to administer even a dormant company it is a good idea to get rid of the company. One way of doing this is to liquidate the company. Since the company is owned by the tenant-owned association it is its responsibility.

The first step of the liquidation process is for the company to have a shareholders' meeting, where it is decided that the company shall enter into voluntary liquidation. An application shall be sent to the Swedish Companies Registration Office, which will appoint a liquidator. The liquidator's task is to liquidate the company. The company can also suggest a liquidator. The board shall hand over an audited financial report to the liquidator. The liquidator from thereon takes over the control of the company from the former Board.

Until the company is dissolved, the company must fulfill all the responsibilities which include annual reports, tax statements and so on. During the liquidation process the company is not allowed to make any dividends. The liquidator must call upon so-called unknown creditors. The creditors that are known to the company will be informed as well. When it has passed 6 months since the notice, the liquidator shall present a report how the assets and liabilities will be handled at a shareholders' meeting. This report shall include all financial reports during the liquidation process and must be audited. After the shareholders' meeting the company is dissolved and when the final report including an application has been registered at the Swedish Companies Registration Office, only then is the company dissolved. The assets and the liabilities are taken over by the owner of the company.<sup>8</sup>

A liquidation process takes at least 7 months to finalize. There are a lot of companies which offer the option of selling the company to them and finalize the liquidation. The tenant-owned association does not have to administer the liquidation process.

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<sup>8</sup> Aktiebolagslagen (2005:551), 25 kap