
Honduras

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

Contacts

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1. INTRODUCTION

In the Republic of Honduras, the main regulation for corporate and commercial law is the Honduran Code of Commerce. It contains the main principles and regulations regarding commercial contracts and agreements. However, agreements relating to mergers and acquisitions are not expressly regulated by the Code of Commerce and are permitted by law under the legal institution of ‘atypical agreements’. According to Article 715 of the Code of Commerce, all atypical agreements are ruled by the covenants and clauses agreed upon in them. If there is an issue not covered in the atypical agreement, the Code of Commerce provides that the applicable legal provision will be that contained in the Code of Commerce or the Civil Code which is most analogous to such issue.

It is important to also consider the Law for the Promotion and Protection of Investments (LPPI), which ensures that foreign investors receive the same treatment as national investors, assuring the non-application of limitations for their entering into Honduran markets. The LPPI also gives prominence to the use of arbitration in investments related to real estate, and the opportunity for foreign investors to enter into stability agreements with the government that guarantee that there will not be an increase in taxes in the national and municipal ordinary regimes for an established period.

There were no regulatory changes introduced during the pandemic that could impact mergers and acquisitions, aside from Decree 33-2020 which broadened the legal recognition of the celebration of agreements through electronic means and developed the provisions found in the Law of Electronic Signatures, and the enactment of some tax regulations that require Companies to report on their shareholder structure and new directors.

2. STRUCTURE OF THE TRANSACTION

In Honduras, transactions for mergers and acquisitions are generally executed through a stock purchase agreement. In these cases, if the buyer is a foreign company, it is very common for a special purpose vehicle (SPV) to be incorporated in Honduras for the purpose of executing the transaction. This legal structure is recommended for mergers as it simplifies some of the legal formalities that would otherwise be required.

Other common types of transactions for mergers and acquisitions are asset and liability acquisitions (asset purchase agreement) and special merger agreements.

3. PRELIMINARY CONSIDERATIONS

In this section, the following points regarding mergers and acquisitions in Honduras should be taken into consideration.

The two most common types of corporate legal organisations are: the corporation (*sociedad anónima* or SA) and the limited liability company (LLC, *sociedad de responsabilidad limitada* or SRL). The capital stock of a corporation is divided into shares that can be represented by (registered or bearer) certificates. The capital of a limited liability company is divided into social participations that are not securities in character, cannot be represented by certificates or book entries, or called tradeable shares of stock. The social participations represent percentages of a 100 per cent capital stock.

Article 43 and 77 of the Code of Commerce require that transfers of social participations of an LLC be authorised by all or a majority of the partners (if agreed in the incorporation charter),

recorded in the Company's Social Participations Book, and executed in a public document to be registered in the Commercial Registry in order to take effect with third parties. The current partners will have a right of first refusal to acquire the social participations during the period of 15 days prior to any third party acquiring same.

In a corporation, the transfer must be recorded in the shareholders' book and shares must be endorsed in favour of the buyer. In some cases, the corporation's bylaws or incorporation charter might require that the shareholder wishing to transfer shares notify, or request authorisation from, the board of directors.

These restrictions must always be taken into consideration when there is a transfer of social participation or shares.

Finally, on the structure of the target company and its influence on transfer formalities, see the summary of the Law for the Generation of Employment, Promotion of the Entrepreneurial Initiative, Formalization of Businesses and Protection of the Rights of Investors (Section 9); this structure does allow for the single-partner company and, if incorporated under the special regime this law regulates, could simplify transfers.

4. TAX CONSIDERATIONS

There are no specific taxes or fees related to mergers and acquisitions, nor are there major differences in the treatment of either an LLC or a corporation. In general terms, a company should be mindful of at least the following taxes.

4.1 Income tax

Legal entities domiciled in Honduras, whether domestic or foreign, will pay a rate of between 15 per cent and 25 per cent on total net taxable income. For the purposes of calculating income tax, income is any kind of revenue, profit, gain, income, interest, product, benefit, participation, salary, wage, fee and, in general, any perception in cash, securities, in kind or credit which modifies the taxpayer's net worth.

Companies must determine their net taxable income by deducting the total ordinary and necessary expenses from their total gross taxable income to produce their net taxable income. This tax is declared and paid annually no later than April 30 of the year following the reported fiscal year.

4.2 Solidarity Contribution

The Tax Equity Law contained in Decree 51-2003, in force as of 5 April 2003, establishes a special surcharge on income tax for legal entities, called the Temporary Solidarity Contribution. As of the latest tax reform of 1 January 2014, this ceased to be temporary and has become permanent. The Solidarity Contribution rate is 5 per cent on the excess of the net taxable income that exceeds HNL 1m. This tax is declared and paid annually no later than April 30 of the year following the reported fiscal year.

4.3 Net asset tax

This is an annual tax applicable on the total net assets of legal entities domiciled in Honduras that have the character of traders in accordance with the Commerce Code. The rate of this schedular tax is 1 per cent on the value of the total net assets determined in the balance sheet as of December 31 of the taxable year. It must be declared and paid on the same date of

payment of the income tax of each fiscal year. This tax is applicable to companies whose assets exceed HNL 3m. The amounts paid will constitute a credit against the value of the income tax to be paid for the respective year. If the amount paid as income tax is equal or higher than the net asset tax payable, it is understood that the obligation is fulfilled, derived from the latter.

4.4 Capital gains tax

Capital gains in Honduras are those resulting from the transfer, assignment, purchase and sale or other form of negotiation of goods or rights, carried out by individuals or legal entities whose usual line of business is not to trade with such goods or rights. Capital gains obtained by natural persons or legal entities domiciled in Honduras, are taxed at the single rate of 10 per cent; hence, they are not subject to the Income Tax Law. The resident taxpayer must file an annual capital gain return no later than April 30 of the tax year following that in which the gain was obtained. The tax must be paid in the first 10 days of the following month in which the gain was obtained by means of an official payment receipt.

Capital gains obtained by non-residents will be taxed with a 4 per cent withholding, calculated on the value of the transaction. Article 14 of Decree No. 113-2011 designates the buyers as the withholding agents. The tax must be declared and paid within the first 10 working days of the following month in which the withholding was made.

4.5 Dividend tax

Pursuant to Article 25 of the Income Tax Law, income received by individuals and legal entities resident or domiciled in the country in the form of dividends, or any other form of profit sharing or reserves, will be subject to a 10 per cent tax. This will be withheld and paid by the company.

4.6 Sales tax

The sales tax applies to all sales of merchandise or goods and services, including delivery food sales, and is currently taxed at the rate of 15 per cent. The rate is increased to 18 per cent when this tax is applied to the importation or sale of beer, liquor, compound liquor and other alcoholic beverages, cigarettes and other processed tobacco products, and first-class airline tickets.

The sales tax is paid by the final consumer and must be paid monthly by the seller of the goods or merchandise or the service provider within the first 10 days of the month following the month in which the sale took place. It will be applied on a non-cumulative basis at the import stage and at each stage of sale of the goods or services.

4.7 Security tax

The security tax may be applied in the operations carried out by the company if the following circumstances occur:

- (a) Debits/withdrawals are generated in savings or checking accounts that have an average monthly balance of the previous month greater than HNL 120,000, or its equivalent in foreign currency.
- (b) National or international transfers are generated for an amount greater than HNL 20,000, or its equivalent in foreign currency.

The corresponding financial institution will withhold the security tax when applicable.

5. PRE-AGREEMENT

It is customary for M&A parties to negotiate and execute a letter of intent, also known as a memorandum of understanding (MOU). The letter of intent is not regulated by either the Code of Commerce or the Civil Code. It has no legal or binding effect as it is considered only a statement of the intentions of the parties for the proposed transaction. On a practical note, these documents should contain:

- (a) the identification particulars of the parties;
- (b) a statement of the intention to negotiate;
- (c) a summary of the steps carried out to date;
- (d) their positioning;
- (e) an explanation of transaction they intend to carry out;
- (f) the terms and conditions to be met or steps to be taken to achieve an understanding;
- (g) the objectives sought; and/or
- (h) the time in which they must be achieved.

Due to the risk that this type of agreement might be interpreted as an offer or option under the Commerce Code, it is recommended that a 'non-binding' clause stating that the document is not legally binding and is not an offer or an option is included. Binding clauses can be included to give certainty to the negotiations, such as confidentiality or exclusivity clauses or clauses restricting parallel negotiations, among others.

6. DUE DILIGENCE PROCESS

It is common practice for the parties to agree in the letter of intent to carry out a due diligence process before perfecting the purchase transaction, usually through the purchaser's advisers and at the purchaser's expense. This enables the purchaser, among other things:

- (a) to identify the risks and contingencies associated with the target company (or its assets);
- (b) to obtain elements to determine the value of the target to be acquired;
- (c) to obtain valuable information for the negotiation;
- (d) to identify potential synergies;
- (e) to determine the structure of the transaction;
- (f) to determine the solidity of the proposed investment; and
- (g) to determine the level of security that will need to be requested from the vendors in the purchase agreement.

Generally speaking, a due diligence process for a share purchase is usually more complex and involves a greater amount of research than for an asset purchase. In asset transfers, it is common practice in Honduras to study how the ownership of the various assets can or must be transferred. For example, for the transfer of real estate, intellectual property or administrative concessions, it will be necessary to obtain a public document of transfer for registration as applicable. In this case, the purchaser will also analyse whether the agreements and the obligations and rights under those agreements can be assigned with or without the consent of the other party.

In the case of the transfer of shares, it is important for the review of agreements to include an examination of change of control clauses. These clauses usually allow the other party to

terminate the agreement or amend its terms and conditions if, for example, the shareholder or shareholders holding the majority of the shares in a company cease to hold them. If such a clause exists, the purchaser will have to consider whether to obtain the prior acceptance of the other party, or whether to include the third party's consent in the purchase agreement as a condition precedent to the transaction.

The result of the due diligence process will necessarily have an impact on the most characteristic clauses of the purchase agreement – the representations and warranties that the purchaser requests from the vendor.

7. ANTITRUST CONCENTRATION CONTROL ISSUES TO BE TAKEN INTO ACCOUNT IN A MERGER OR ACQUISITION TRANSACTION

The Honduran Law for the Defence and Promotion of Competition (LDPC) provides that foreign entities are subject to the LDPC when their activities, agreements, practices, covenants, arrangements or business acts have effect in Honduras. Article 13 of the LDPC provides the obligation for economic agents to notify of the economic concentration of any transaction that causes a change in control.

Based on the strict interpretation of this provision, the conservative and advisable approach is to provide a notification for all transactions resulting in a change in control of a Honduran entity or being carried out with a business in the country. This notification must be filed before the concentration has any direct effect or any legal or material effect in the Honduran territory, making the agents subject to fines in case of breach of this obligation.

8. ACQUISITION AGREEMENT

Regardless of the structure of the transaction, acquisition agreements have the following five common features:

- (a) representations and warranties;
- (b) pre-closing covenants;
- (c) conditions precedent to closing;
- (d) indemnification; and
- (e) dispute resolution.

8.1 Representations and warranties

The seller and the buyer will make representations and warranties to each other in the acquisition agreement. The seller's representations and warranties typically make up the largest part of the acquisition agreement.

Representations and warranties serve three important purposes. First, they are informational. The seller's representations and warranties, coupled with the buyer's due diligence, enable the buyer to learn as much as possible about the seller's business prior to signing the definitive acquisition agreement.

Second, they are protective. The seller's representations and warranties provide a mechanism for the buyer to walk away from, or possibly renegotiate the terms of, the acquisition if the buyer discovers facts that are contrary to the representations and warranties between the signing and the closing.

Third, they are supportive. The seller's representations and warranties provide the framework for the seller's indemnification obligations to the buyer after the closing. As a guarantee for the representations and warranties, the execution of escrow agreements is the general rule. The most common representations and warranties include:

- (a) corporate organisation;
- (b) authority and capitalisation;
- (c) assets
- (d) liabilities;
- (e) financial statements;
- (f) taxes;
- (g) contracts, leases, and other commitments;
- (h) employment matters;
- (i) compliance with laws and litigation;
- (j) product liability; and
- (k) environmental protection.

8.2 Pre-closing covenants

Typical negative covenants (covenants that restrict the seller from taking certain actions prior to the closing without the buyer's prior consent) include:

- (a) not changing accounting methods or practices;
- (b) not entering into transactions or incurring liabilities outside the ordinary course of business or in excess of certain amounts;
- (c) not paying dividends or making other distributions to stockholders;
- (d) not amending or terminating contracts;
- (e) not making capital expenditures;
- (f) not transferring assets;
- (g) not releasing claims or waiving rights; and
- (h) not doing anything that would make the seller's representations and warranties untrue.

Typical affirmative covenants (covenants that obligate the seller or the buyer to take certain actions prior to the closing) include:

- (a) allowing the buyer full access to the seller's books, records, and other properties;
- (b) obtaining the necessary board and stockholder approvals;
- (c) obtaining the necessary third-party consents; and
- (d) making the required governmental filings and obtaining the required governmental approvals.

8.3 Conditions precedent to closing

All merger and acquisition agreements provide that, as a condition to closing, the representations and warranties of the parties must be true and correct at closing, and that the pre-closing covenants have been performed or fulfilled prior to closing.

This is confirmed by each party delivering to the other party a written certificate to that effect. Other typical conditions to closing include:

- (a) receipt of the necessary third-party consents;
- (b) receipt of the necessary governmental approvals;

- (c) receipt of legal opinions and other closing documents;
- (d) receipt of certain financial statements or the achievement of certain financial milestones;
- (e) receipt of employment or non-competition agreements from key employees; and
- (f) satisfactory completion of the buyer's due diligence of the target's business.

8.4 Indemnification

The seller will try to limit the time period after the closing for which it has indemnification obligations. In theory, this time period should be based upon the reasonable period of time within which the buyer, through reasonable diligence, will discover any breaches or misrepresentations or, if applicable, the time period within which a third party would make its claim. In practice, the parties generally agree on a period of one to three years after the closing. Exceptions may be made for environmental and tax liabilities, for which the time period may be the applicable statute of limitations.

The seller will also try to impose a cap on the total amount of its indemnification liability. Many sellers try to cap their liability at an amount less than the total purchase price. Many buyers will agree to a cap equal to the total purchase price. If the seller's business is 'clean,' the risk to the buyer in agreeing to an indemnification cap may be small.

Finally, the seller will try to negotiate an indemnity 'basket' or a 'deductible' on its indemnification obligations to eliminate small indemnification claims.

8.5 Dispute resolution

Arbitration is now the most common dispute resolution method established in all acquisition documents. The arbitration is usually set outside of Honduras if a foreign acquirer is involved; however, parties are increasingly relying on arbitration centres in Honduras as the choice of forum.

9 LAW FOR THE GENERATION OF EMPLOYMENT, PROMOTION OF THE ENTREPRENEURIAL INITIATIVE, FORMALISATION OF BUSINESSES AND PROTECTION OF THE RIGHTS OF INVESTORS

The Law was approved by the National Congress with the objective of facilitating the formalisation of commercial activities and encouraging the development of entrepreneurship. It establishes a corporate regime that is applicable to all types of companies recognised by the Commercial Code, except for those whose purpose is the development of activities subject to special regulations and supervision by the state. It establishes regulations regarding corporate modifications such as mergers, divisions, capital increases and others.

The new regime establishes some significant changes in relation to the constitution of mercantile companies and their corporate functioning. Article 3 of the Law mandates that companies created under this regime must be constituted through a unique special form, created by the Mercantile Registry, which must be available in physical format or in electronic format.

The registration must be done in a unique electronic register at national level. The Registrar will receive the registration form and only verify that the purpose of the company is valid and legal, which will subsequently assign the registration number, digitise it and save it in the database of the Mercantile Registry. This form will be considered the articles of incorporation of the company.

According to Article 12 of the Law, modifications, transformations, mergers, divisions, capital increases, or other acts, may also be carried out through this form. Constitution, modifications, transformations, mergers, divisions, and capital increases by means of forms, will only proceed in the event that the company was constituted under the regime established in this Law. However, though the form for the incorporation of new companies is already being applied, the Mercantile Registry has not as of yet issued the forms necessary for other types of corporate actions and decisions, such as those mentioned in Article 12 of the Law; these need to still be performed in a traditional physical format, with the assistance of a notary.

Another relevant change is the ability for companies created under this regime to have a single partner, according to Article 5 of the Law. This article also states that the establishment of minimum capital will be voluntary and that companies with no minimum capital and more than one partner or shareholder must indicate the percentages (or shares) of each partner or shareholder. This Law also contains changes in relation to the way in which the corporate governance of the companies incorporated under this regime should be managed; for example, Article 6 establishes that the companies incorporated under this regime may control the shareholders' meetings or the acts of their administrative organs in electronic format. In addition, no authorisation or notification from any central, departmental or municipal government authority of the company's social and accounting books will be required. Likewise, the same article establishes the possibility of recording meetings on video. In these cases, it will not be necessary to keep shareholders' or board of directors' minutes books.

The Law also increases the protection for minority shareholders, giving them additional powers to inspect the work of the company's directors, as included in a reform by the Law to Article 157 of the Commerce Code. Also, any shareholder or group of shareholders that constitutes at least 5 per cent of the company's participation can move the date for any major voting during a shareholders' meeting in if there is a matter they do not feel they are sufficiently informed about, according to the reformed Article 189 of the Commerce Code.