www.pwc.com/goingglobal

Real Estate Going Global

Spain

Tax and legal aspects of real estate investments around the globe

2012

pwc

Contents

All information used in this content, unless otherwise stated, is up to date as of 2 August 2012.

Real Estate Tax Summary – Spain

Direct taxation

Investment through a Spanish subsidiary

The net income of a Spanish entity is taxed at 30%. When investing through a real estate investment fund or company, a reduced rate of 1% applies. The Spanish REIT (SOCIMI) is subject to a corporate income tax of 19%, and is applicable to qualifying subsidiaries of REITs listed in the EU or EEA.

Financial expenses capping rule

The financial expenses-capping rule limits tax relief for net financial expense to 30% of the operating profit, with a minimum of EUR 1m treated as tax deductible. Financial expenses disallowed can be carried forward for 18 years, increasing the interest expense in the subsequent years, which will be subject to the 30% limit (with the exception of the period of liquidation and winding up.

Depreciation

Generally, an annual 2% depreciation charge on property (exclusive of land) is allowed. The depreciation charge allowed for industrial buildings is 3%. Depreciation rates can be doubled in the case of buildings considered as used assets, i.e. of more than ten years.

Loss carryforward

Tax losses incurred by a PE or Spanish subsidiary can be carried forward 18 years and may offset capital gains or ordinary income. For newly created companies incurring losses, the 18-year period will start to compute once profits are achieved.

Withholding tax

Dividends payable to the parent foreign company are withheld at a 19% rate on the gross (21% in 2012-2013), or at a reduced rate, which on average is 10%, provided by the relevant double taxation treaty.

Provided that the conditions under the Parent-Subsidiary EU Directive are met, dividends paid to EU resident companies will not be subject to withholding in Spain. However, the Spanish anti-abuse clause must be carefully considered.

Interest is also subject to a 19 % withholding tax (21 % in 2012-2013) or at a reduced rate depending of the relevant treaty applicable. However, interest payable to EU resident lenders is withholding tax exempt.

In principle, rents are subject to a 19 % withholding tax (21 % in 2012-2013). However, this withholding may be avoided by the landlord if a Business Tax certificate is obtained.

Capital gains on the sale of property

Capital gains are taxed at a 30% rate using a specific tax calculation in which the acquisition cost may be updated. However, taxation may be reduced to an effective 18% tax rate through a 12% tax credit, provided that the property is considered a business asset rather than inventory, and the company meets the reinvestment conditions established by the law. These conditions, among other circumstances, require the reinvestment to be made within a term of one year prior to the disposal of the property or three years after said disposal.

As a measure to stimulate transactions within the real estate market, future capital gains on disposal of urban properties qualifying as fixed assets and acquired between 12 May and 31 December 2012 shall be 50% tax exempt.

Capital gains on the sale of shares of real estate companies

The disposal by a non-resident entity of shares in Spanish entities in which the assets are mainly composed of Spanish property is subject to a 19% tax rate (21% in 2012-2013), unless the sold shares are held by a company resident in a state where the double tax treaty between that state and Spain does not grant Spain taxing rights over capital gains stemming from the disposal of shares of a Spanish real estate company.

Direct investment through a permanent establishment in Spain

A business structure (permanent place of business, employees, empowered agent, or any other treaty requirement) is needed for a PE. The net income (gross income less interest, depreciation, salaries and other expenses) is taxed at a 30% rate.

When the income obtained by the PE is transferred abroad, complementary taxation of 19% on gross income is levied (21% in 2012-2013). This does not apply when the head office is located within the EU, or when the relevant double taxation treaty does not recognise such an additional tax (which is so in the majority of the cases).

Direct investment without a permanent establishment

Non-residents operating in Spain without having a Spanish PE are taxed at 24% on their gross income, i.e. no deduction of expenses is allowed (24.75% in 2012-2013). However, EU residents without a PE should be allowed to deduct those expenses allowed pursuant to the Individual Income Tax Act, as long as they are directly related to the income obtained in Spain and the taxpayer can provide supporting evidence that this is the case. The resulting scenario would be that regular net income obtained by EU residents without a PE would be taxed at 24% compared with taxation at 30% on net income obtained by PEs. In addition, capital gains taxation stands at 19% for non-residents without a PE (21% in 2012-2013) as opposed to 30% for PEs with recourse to reinvestment relief.

Indirect taxation

Value added tax (VAT)

In general terms, the acquisition of new buildings and urban land are subject to VAT at a rate of 18% (21% effective from 1 September 2012).

Transfers of rural lands, and used buildings are exempt from VAT. Used for this purpose means that the building is transferred for the second or subsequent time, except when the building is acquired for rehabilitation. Nevertheless, the option to VAT may be implemented and, accordingly, the transfer may be subject to VAT under certain circumstances.

Letting of commercial property is always subject to 18% VAT.

Transfer tax

A transfer tax, typically of 7%, depending on the location of the real estate, is levied on transfers not subject or exempted from VAT. The transfer of real estate qualifying as a going concern is subject to transfer tax as opposed to VAT.

Transfers of shares in companies where at least 50% of their assets consist of property in Spain are subject to transfer tax when, as a result of the transfer, the acquirer achieves a dominant position, which is deemed to have happened when the acquirer's share capital in the company rises to more than 50%. It should be noted that the Spanish regulations in this respect have been subject to the EU scrutiny.

Stamp duty

Normally, a 0.5% to 2% stamp duty arises jointly with VAT, and when some transactions related to real estate operations are documented in a public deed, such as mortgages, new building deeds, etc.

Municipal taxes

Business tax

Any business developed in Spain is subject to business tax levied on a yearly basis. Its cost will depend on the specific activity carried out by taxpayers. Business activity tax is deductible for corporate tax purposes.

Exemptions are available: First two years of activity; Taxpayers with an annual turnover under EUR 1m (according to the last corporate income tax return filed); individuals.

Real estate tax

Real estate tax is levied on an annual basis and the tax rates may range from 0.4% to 1.10%, applicable to the cadastral value of urban properties, and 0.3% to 0.9%, applicable to the cadastral value of non-urban properties. Such a rate is increased or decreased by the local authorities, depending on the specific location of the property. The taxpayer is the owner of the real estate. Real estate tax is deductible for corporate tax purposes.

Tax on increase of value of urban land

A tax on the increase of the value of urban land will accrue upon the transfer of urban land. The taxpayer is the seller.

Tax on construction, installation and building projects

A tax levied on construction, installation and building projects applies to the effective cost of the work. The taxpayer is the owner of the construction work, not necessarily the owner of the building. It is a deductible expense for corporate tax purposes.

The maximum tax rate will be 4%, depending on the population of the municipality where the works are carried out.

Real Estate Investments - Spain

Understanding the basic principles

Legal environment

Definition of real estate activities

For legal purposes, the definition of real estate promoter is included in the Building Act and is legally defined as the person, individual or entity that decides programmes and finances the building works, to be enjoyed by itself, or to be sold or leased. Real estate promoters have several obligations, as follows:

- to hold legal title to the land that allows the promoter to build on it;
- to provide the relevant data needed to prepare the building project;
- to obtain the prior compulsory licences and administrative authorisations;
- to subscribe such insurance policies as are compulsory under the scope of the law;
- to deliver to the transferee the documentation regarding the work executed.

For legal purposes, the definition of real estate lessor is included in the civil code and in the Urban Leases Law, and is legally defined as the person, individual or entity that leases urban real estate, either a dwelling, premises or for commercial activities.

Financial lessors are defined in the Law of Discipline and Intervention of Credit Entities. Under this definition, only financial institutions duly registered in the CNMV (Spanish Securities Exchange Commission) may lease assets under the scope of financial leasing agreements.

For tax purposes, the definition of real estate activities is included in the VAT Act, and in the Local Revenue Act regarding business tax. For corporate tax purposes, there is no specific definition, nor are there any specific regulations applicable to real estate promoters or lessors; so accounting rules are applicable to determine the taxable income of these activities, taking into account the exceptions contained in the Corporate Tax Act.

Please note that, as from March 2005, there are more obligations for lawyers, notary publics, accountants and entities in charge of real estate-related activities, among others, to obtain and deliver information periodically to the Executive Service of the Commission for the prevention of money-laundering activities.

The property right

The private property right is contained in the Spanish constitution and regulated in the civil code and other civil regulations. According to the constitution, no one can be deprived of their property except in the case of just cause of public utility or social interest, by means of the corresponding indemnification established by law.

The transfer of private property must be recorded at the Land Registry in order to be enforced *vis-à-vis* third parties.

Public property is recognised both in administrative regulations and in zoning regulations. The public authorities can own premises under private legislation and public legislation.

The ground lease right (*derecho de superficie*)

This *in rem* right is a special right over the surface of the plot, which permits the construction of buildings over or under the land that does not belong to the constructor. It may also be granted over existing constructions. The granting of this right implies the division of the ownership of the plot between the owner and the ground lessee until the end of the stipulated term. Once that term has expired, all the constructions owned by the ground lessee will be the property of the owner.

As from July 2007, the ground lease is regulated in the Spanish Urban Planning Act. This Act provides that the ground lease must be granted by the owner of the plot before a Public Notary, and the deed must be recorded at the Land Registry, in order to be legally established. The term of the ground lease cannot exceed 99 years in any case.

The deed may also establish additional regulation of the ground lease right:

- Agreements concerning acts of disposal by the ground lessee.
- Guarantees *in rem* to secure the performance of the contract.
- Provisions regarding the construction (time limits, type of construction, etc.).

Construction right

According to the Urban Planning Law regulated by the state, the owner of a plot has the right and the responsibility to construct. However, the owner must obtain specific licences, and be aware of having to comply with several compulsory rules, failing which the ultimate sanction could be the demolition of the construction.

Usufruct right and other figures of divided property

The Spanish civil code contemplates the right to use and have the benefit of the plot granted to the owner to another person. This right can be onerous or free, and can be for the entire life of the person to whom it is granted or, on the contrary, just for a specified term.

This type of right is customary in Spanish heritage law. The principal is legally obliged to grant this right to over one-third of their properties to the widow/widower (unless otherwise provided in the principal's will and subject to the provisions of the Spanish civil code).

This right can be recorded at the Land Registry in order to be enforceable *vis-à-vis* third parties, for which purpose it is granted before a Public Notary prior to the recording.

Regarding other figures of divided property, indivisible property (*propiedad pro-indiviso*) is worthy of mention. This is a kind of property owned by two or more persons indivisibly, i.e. it not being possible to make a physical division of the property among the different persons that own the plot in a specified percentage.

Another form of divided property is the regime of community of owners of a building. In this form, the building is divided into premises or flats, which are owned by one person or many persons as separate property, as the case may be, there being certain common areas that belong as indivisible property to the community. This is similar to the concept of condominium ownership.

These two types of divided property are regulated by the civil code, real estate code and other civil regulations. They can be recorded at the Land Registry in order to be enforceable *vis-à-vis* third parties.

Finally, the time-sharing property scheme should be taken into account, as will be explained below.

Lease contracts

Lease agreements are specifically included in the civil code, which distinguishes between urban leases and rural leases. With respect to urban leases, these are regulated in the Urban Leases Law, distinguishing between residential and non-residential urban leases.

Although they are considered personal rights, lease agreements can be recorded at the Land Registry, pursuant to the real estate code, which has taken into account the protection that the lessee needs before third parties who can acquire the land or premises that the lessee occupies.

Administrative concessions

The public authorities can grant administrative concessions over plots or premises with public utility in favour of natural persons or legal entities, selected by tender. According to these concessions, the concessionee can carry out works and develop activities in order to obtain profits.

These concessions are regulated by administrative law and civil law. They can be recorded at the Land Registry over the plot in order to be known by third parties.

Town Planning regulations

The urban planning competence for legislation is transferred to the regional authorities (Autonomous Communities) in Spain, with the exception of the regional authorities of Ceuta and Melilla, where the central state authorities have legislative capacity.

On the other hand, the town halls also have competences in several kinds of planning proceedings as well as all the matters related with the granting of the building licences.

The urban planning laws regulate three different areas, which are the following:

- Zoning: it is the first step of the Urban Procedure and defines the different kind of planning instruments. The main document under planning regulation for each municipality is the General Master Plan. It is the cornerstone of Spanish planning law. It is a general and comprehensive town and country planning document and relates to an individual municipality. The PGOU establishes the main rules and guidelines and also chooses which planning model applies. The practical achievement of the PGOU depends on the class of land, which is established by the PGOU itself and various other planning instruments.

- Management: it refers to the development and implementation of the projects that Spanish Administration use to organise and distribute the land in some specific areas, attending the town planning elaborated by local administrations. The object is to redistribute between the owners all the rights and charges that result from the plan.

- Licences and authorisations: for the development of activities in premises

Although the regulation of these authorisations and licences varies from one municipality to another, there are four basic different types of licences necessary to build and carry on a business in Spain from a general point of view:

- A building licence (*Licencia de Obras*).
- An activity licence (Licencia de Actividades e Instalaciones).
- A first occupation licence (*Licencia de primera ocupación*).
- An opening or operating licence (Licencia de Apertura o Funcionamiento).

Licences are regulated by regional regulations (*normativa autonómica*) and finally, municipal regulations (*normativa municipal*). According to those regulations, the regimen of the licences can change. It has to be taken into account that the licences are granted by the town hall authorities. This means that the process to obtain the licences may vary in the different municipalities regarding term, resolution, documentation requested, etc.

Tax environment

This section analyses the general principles governing Spanish taxation of real estate investments. In this respect, it should be noted that the analysis of the particular tax provisions that might be applicable in the different Spanish autonomous communities, and especially in the Basque Country, Navarre and the Canary Islands, are outside of the scope of this brochure.

The scope of Spanish taxation

Under Spanish domestic law, income and capital gains triggered by Spanish real estate properties are taxable in Spain, whether realised by a Spanish resident or non-resident. Moreover, Spanish law provides for the taxation in Spain of capital gains stemming from the sale, by a non-resident, of the shares of a company, whether or not Spanish, whose principal assets consist of Spanish properties.

The application of these provisions to non-residents depends on the contents of the tax treaty that binds Spain and the country of residence of the owner of the properties or shares of real estate companies.

Most of the tax treaties concluded by Spain stipulate, according to article 6 of the OECD Model Convention, that real estate income is taxable in the country where the property is located. Yet, only through a case-by-case analysis will it be possible to determine whether Spain has the right to tax or not.

Income/capital gains tax

There are no separate taxes for income and capital gains in Spain.

Resident entities

Spanish resident entities are subject to Spanish corporate tax on their worldwide net income and capital gains.

Taxable income generated by resident companies is subject, as a general rule, to a flat corporate tax rate of 30%.

For corporate tax purposes, the starting point to determine taxable net income and capital gains is the company's annual accounts. Nevertheless, adjustments are normally required in order to bring the annual accounts figures in line with tax rules.

Rules governing the accounting results are contained in the Commercial Code, Corporations Act and in the General Accounting Plan. New Spanish GAAP rules came into effect as of January 2008. However, special accounting rules for real estate entities have not been enacted, but the old real estate accounting plan would remain applicable as long as it is compatible with general GAAP.

Net income is generally determined on an accrual basis, i.e. income has to be attributed to the year to which it economically pertains.

Spanish tax regulation requires that transactions carried out between related parties comply with arm's length principles. Transfer pricing regulations oblige taxpayers directly to price their intercompany operations at arm's length and impose the obligation to make available to the tax administration, documentation that justifies the prices applied. All domestic and international transactions between related entities must be valued at arm's length for tax purposes and be duly documented.

Corporate tax returns must be filed annually, within 25 calendar days following the six months subsequent to the end of the tax period.

Corporate tax must be paid on a prepayment basis at periodical intervals throughout the financial year.

Joint ventures (*Unión Temporal de Empresas* (UTEs))

Joint ventures are especially used by construction and engineering companies when a contract is given to more than one company. They are treated as Temporary Consortia companies, not paying corporate tax on the part of taxable income imputable to the member resident company. However, this tax regime will not be applicable to the portion of the taxable base of the joint venture attributable to non-resident members. This taxable base is taxed at the general tax rate of the corporate income tax, i.e. 30%.

Community of owners and civil partnerships

Income corresponding to communities of owners and partnerships that carry on business activities as entrepreneurs will be attributed to common owners or participants, respectively, in accordance with the rules or agreements applicable in each case.

These are forms used to develop real estate activities in Spain in order to avoid the tax and administrative costs of incorporating a company. Notwithstanding the above, special care regarding the liability regime applicable to the members of these forms must be considered. Both of them are regarded as VAT taxpayers.

Participatory account contract (*contrato de cuentas en participación*)

This is a type of legal contract whereby an owner of land transfers, or merely allows an entrepreneur named as a management participant, normally the constructor, to use the land. As consideration for such use, the management participant must pay a portion of the profits obtained in the developing of the real estate promotion, or in the business carried out on the land, to the non-management participant.

The remuneration paid by the management participant to the non-management participant, i.e. the owner of the land transferred or contracted to the management participant, is tax-deductible for corporate tax purposes.

Resident individuals

Resident individuals are subject to Spanish personal income tax on their worldwide income.

Trusts are not specifically recognised under Spanish law.

The personal income tax base shall be taxed at the progressive rates stated in the state and autonomous communities' scales with a marginal tax rate of 52% in 2012 and 2013. Nevertheless, capital gains generated are subject to a flat rate of 19% (21% on the amount exceeding EUR 6,000). For years 2012 and 2013, rates have been increased (in tranches): 21% for gains up to EUR 6,000, 25% between EUR 6,000 to EUR 24,000, 27% for gains above EUR 24,000). Under Spanish personal income tax legislation, income stemming from real estate assets can fall within the following categories:

- Returns on real estate.
- Business earnings, determined pursuant to corporate tax rules.
- Capital gains or losses.

Capital gains and losses derived from properties applied to the real estate activity carried out as a business activity, such as the facilities used for the real estate activity, shall not be considered as business earnings, and will be taxed according to the tax regime applicable to capital gains and losses described below.

Net wealth tax

Before 2008, resident individuals were subject to wealth tax on their worldwide net wealth, and non-resident individuals on their net assets located in Spain. However, a law passed in December 2008 abolished in practice this tax through a 100% tax rebate with retroactive effect to January 2008 for both resident and non-resident individuals. However, regions have been entitled to reintroduce this tax for 2011-2012.

Non-resident entities and individuals

Non-resident entities and individuals are subject to taxation in Spain solely on their Spanish source income.

The basis for taxation of a direct property investment in Spain held by a non-resident will depend on the status of the non-resident for Spanish tax purposes. Permanent establishment (PE) investment is taxed at a 30% rate on the net income and capital gains. On the other hand, non-PE investment is taxed at a rate of 24% on the gross income (24.75% in 2012-2013), plus a separate rate of 19% on the capital gains (21% in 2012-2013).

However, EU residents without a PE should be allowed to deduct those expenses allowed pursuant to the Individual Income Tax Act, as long as they are directly related to the income obtained in Spain and the taxpayer can provide supporting evidence that this is the case. In particular, this means that, for real estate lease activities carried out by an EU resident with no fixed place of business in Spain, the taxable base would be made up of rental income less expenses as opposed to the current gross rental income system.

Spanish domestic legislation provides a 19% branch tax applicable to entities' PE investments (21% in 2012-2013), but not to individuals. This tax can be avoided when the head office is resident in an EU member country, or in a country that has signed a treaty with Spain, which does not contain any provisions on branch tax, subject to reciprocity conditions.

Value added tax (VAT)

General

The basic concepts of the Spanish VAT regime, such as taxable persons, nature of the goods, delivery of goods and supply of services, have been made consistent with the 6th EC Directive. As a result, Spanish VAT regulations are comparable to those applicable in the other EU Member States. VAT grouping rules are available.

The current Spanish standard VAT rate is 18% (21% effective from 1 September 2012).

For VAT purposes, a PE exists when a real estate is leased in Spain. The PE for VAT purposes must be registered before the Spanish tax administration as a VAT taxpayer, even when it would not be considered as PE for income tax purposes.

VAT-registered entities are required to file VAT returns on a quarterly or monthly basis (dependent on the quantum of turnover). Where a Spanish VAT-registered company was in a net VAT repayment position in respect of a calendar year, a refund could be claimed during January of the following year. The Spanish tax authorities would then have a period of six months in which to make a repayment where due, after which point the tax authorities would also be liable to pay repayment interest. In order to alleviate this financial cost, net input VAT can be recovered on a monthly basis.

Transfer of property

For Spanish VAT purposes, property qualifies as goods and the transfer of property as a supply of goods.

The general rule is that the transfer of newly developed or redeveloped property located in Spain carried out by VAT taxpayers is subject to VAT, whereas the transfer of used property is VAT-exempt and subject to transfer tax.

In addition, the transfer of urban land carried out by VAT taxpayers is subject to VAT, whereas the transfer of land that does not fulfil the qualification for urban land is subject to transfer tax.

However, Spanish VAT legislation provides a specific rule for VAT-exempt real estate transfers, so that the transaction may be VAT-able.

Nevertheless, the acquisition of shares in a company, where at least 50% of assets being real estate located in Spain, is subject to transfer tax typically at a 7% rate when, as a result, more than 50% in the shareholding of the company is, directly or indirectly, achieved. The Spanish Supreme Court has recently referred a preliminary question to the ECJ to conclude on the compatibility of such rules with the VAT Directive and with the freedoms of establishment and movement of capital.

Letting of property

Supply of services means any transaction that does not constitute a supply of goods. Supplies of services on property fall within the scope of Spanish VAT with the exception of the lease of dwellings, which is subject to transfer tax.

Other indirect taxes

Transfer tax

Transfer tax can be an important cost factor, not only in asset deals, but also in share deals.

Transfer tax is levied on the transferee of the property, typically at a 7% rate, depending on the autonomous community in which the property is located, on the fair market value of the property at the time of acquisition, when the transferee is a non-VAT taxpayer, or when the transfer is declared VAT-exempt. The transfer of real estate qualifying as a going concern is subject to transfer tax as opposed to VAT.

Transfer tax is also levied on income arising from the leasing of dwellings, at a reduced tax scale on an annual basis.

Capital tax

Capital tax may be applicable under an indirect investment structure carried out through a Spanish company. Even though incorporations and share capital increases are exempt, decreases of share capital are subject to capital tax at 1%.

On the other hand, the incorporation of a PE is subject to capital tax in Spain at a rate of 1%, provided that the head office is resident in a non-EU country.

In this case, the taxable base would consist of the greater of the following amounts:

- Funds formally assigned to the PE in the deed of incorporation.
- The result of applying, during the first year of activity of the PE, the proportion between the turnover of the PE and the total turnover of the head office to the fiscal capital of the head office as defined by Spanish tax law, which is net worth excluding the results of the year.

If additional funds were assigned to the PE, capital tax will also be due. In this case, the same rules concerning the calculation of the taxable base would be applicable.

Direct real estate investments that do not constitute a PE will not be subject to this tax.

Furthermore, capital tax will not be levied when the holder of the PE is a non-resident individual.

Stamp duties

Stamp duties are incompatible with transfer tax, but not with VAT. Therefore, the transfer of a property subject to VAT can also be subject to stamp duties, at a 0.1% to 1.2% rate – depending on the location of the property – applicable to the value of the transferred asset, provided that the transfer is documented in a public deed and that such deed has to be registered in a public registry.

Notwithstanding the above, when real estate is acquired in a VAT transaction as a consequence of the waiver of the applicable exemption, the tax rate could range between 1% and 2%, depending on the autonomous community.

Mortgages are subject to stamp duties also at a rate of 0.1% to 1.2%, depending on the location of the property. No stamp duties are levied on any other kind of loans, even participating loans or any other kind of debt instrumented in securities, provided that they are not secured by a mortgage.

Local taxation

Local taxation may have a relative importance, depending on the characteristics of the activity in particular:

- Business tax, on the specific activity carried out by taxpayers.
- Real estate tax, on the ownership of the property.
- Tax on increase of value of urban land, upon the transfer of urban land.
- Tax on construction, installation and building projects, applicable to the effective cost of the work.

Direct purchase of assets

Legal aspects

The pre-contract: purchase option, promise to sell/buy

Pre-contract, such as purchase options or the promise to sell or buy, can be executed before a notary or, alternatively, privately between parties. They can be recorded at the Land Registry according to what is established in the Real Estate Code and Normative applicable.

Purchase option

With the pre-contract known as the purchase option, the seller, referred to as a promisor, undertakes during a certain term, the obligation to sell to the other party, the beneficiary, the property (object of the contract) on the date when the beneficiary gives notice of its will to buy the said property.

The fact of the beneficiary accepting the promise by signing such a preliminary contract does not in any way represent an undertaking to buy. The beneficiary simply acknowledges the promise of the seller, the sole party bound by the contract.

When the beneficiary exercises the option to buy, the sale is completed. Failing this, the seller is released from their promise, and is free to sell the premises to a party other than the beneficiary.

There can be an option price fixed by mutual agreement between the parties.

The purchase option will be enforceable vis-à-vis third parties if it is duly recorded at the Land Registry. For such recording at the Land Registry of the purchase option, the requirements according to the Real Estate Code are as follows:

- Mutual agreement between the parties in relation with the recording.

- Price determined for the acquisition of the premises and, if any, the price established for the option.

- Term to exercise the option, required to be less than four years, except in the case of a lease with purchase option, in which the term will be the same as the lease. But in case of extension of the lease, the option expires.

Promise to sell/buy

According to the Spanish civil code, the promise to buy or sell, when there is an agreement between parties concerning the object and the price, will give the parties the right to claim the performance of the contract. This means this type of contract implies a reciprocal undertaking binding the parties to perform it.

Exchange control regulations

The acquisition of real estate valued more than EUR 3,005,060.52, or the incorporation of a Spanish subsidiary or a branch made by non-Spanish nationality investors, is considered as foreign investments in Spain, and needs to be communicated to the Investment Registry belonging to the *Ministerio de Economía y Hacienda*, once they have been carried out.

The acquisition of any real estate by an investor located in a territory previously defined as a tax haven is also considered a foreign investment in Spain. In any event that the foreign investor is located in a tax haven, the communication mentioned above needs to be submitted to the Investment Registry before the execution of the investment.

Tax aspects

50% exemption on capital gains derived from real estate.

As a measure to stimulate transactions within the real estate market, future capital gains on disposal of properties acquired between 12 May and 31 December 2012 shall be 50% tax exempt.

The exemption is applicable to taxpayers of Corporate Income Tax, Individual Income Tax, and Non-Resident Income Tax (without a permanent establishment in Spain).

For Corporate Income Tax purposes, the conditions of the exemption are the following:

- Eligible assets are those urban properties (i) qualifying as fixed assets (i.e. not stock), and (ii) acquired within the above given time frame;

- A 50% exemption is applicable on capital gains obtained at any time after the entry into force of this new rule;

- Impairment in value of the properties, if any, is disallowed for the calculation of the exemption;

- Transactions, acquisitions and transfers between entities of the same corporate group are disallowed for exemption purposes;

The 50% exemption is compatible with the reinvestment relief (reducing the effective taxation rate to 9%).

VAT/transfer tax

The following operations, when carried out by VAT taxpayers, are subject to VAT.

Transfer of property or rights on property.

- Urban land (i.e. land ready for development) or land under urbanisation in progress (i.e. preparing the infrastructure for development of the area), at 18% (21% effective from 1 September 2012).
- Buildings still in construction, at 18% rate (21% effective from 1 September 2012).
- First transfer of new dwellings, at an 8% rate (10% effective from 1 September 2012), or at a 4% rate if under 'official protection' regime.
- First transfer of other new premises and commercial buildings, at an 18% rate (21% effective from 1 September 2012).
- Transfers of buildings for rehabilitation, at 18% (21% effective from 1 September 2012).
- Transfers of buildings to be demolished, in order to carry out a new real estate promotion, at 18% (21% effective from 1 September 2012).
- Transfers of purchase options on real estate, at 18% (21% effective from 1 September 2012).
- Transfers of a ground lease right, at 18% (21% effective from 1 September 2012).

Otherwise, transfers of used buildings and rural land are, in general, exempt from VAT, and subject to transfer tax. However, Spanish legislation provides a rule for renouncing to such an exemption, in order to submit the operation to VAT taxation.

On the other hand, the acquisition from non-VAT taxpayers of property located in Spain is subject to transfer tax typically at a 7% rate on the fair market value of the property at the time of acquisition.

Option to VAT

This is a commonly used procedure that does not need prior approval from the tax authorities.

In order to qualify for a waiver, it is required basically that the buyer must be a VAT taxpayer, eligible for the full recovery of input-VAT, so that the transaction may be VAT-able. In this respect, it should be noted that the option for a VAT-able transfer is based on a strict formal procedure that needs to be followed carefully in order to avoid transfer tax.

The advantage of the option for a VAT-able transfer is that, as opposed to VAT, transfer tax will not be completely recoverable by the buyer, although transfer tax will be partially recoverable via the corporate tax depreciation of the relevant assets.

It should be noted that there is a bill under discussions which is proposing the reverse charge mechanism to apply to those scenarios where the option to VAT is implemented by the seller. The self-charge mechanism means that the buyer will self-charge VAT. A condition of the option to charge VAT is that the buyer may fully deducts input VAT borne on the acquisition of the property, such that self-output VAT would be fully deductible at the buyer's level.

VAT recovery

Under Spanish rules, VAT can be deducted once a company or entrepreneur begins to output VAT. Notwithstanding the above, the company or entrepreneur is allowed to do a provisional deduction before they begin to output VAT. Such provisional deduction has to be regularised through the application of the average deduction rate corresponding to the first four years of business or professional activities in which the company or entrepreneur will output VAT.

Stamp duties

The transfer of a property subject to VAT is also subject to stamp duties, at a 0.1% to 1.2% rate – depending on the location of the property – (rates are typically higher if the option to VAT has been implemented), provided that the transfer is documented in a public deed and that such deed has to be registered in a public registry.

Acquisition of an entrepreneurial activity as a whole

It is also to be noted that, under Spanish VAT legislation, the transfer of the entrepreneurial activity as a whole may not be subject to VAT. This implies that the buildings transferred as a result of the transfer of the entrepreneurial activity would be subject to transfer tax.

However, the transfer of a leased property would be treated as a regular transfer subject to VAT, provided that neither material means nor staff are transferred.

Acquisition of a Spanish property company

Legal aspects

Corporations in Spain

There are two kinds of companies that limit the liability of its shareholders for the amount of stock capital previously contributed by each of them. These companies are the limited liability company, or *Sociedad de responsabilidad Limitada* (S.L.), and the private limited company, or *Sociedad Anónima* (S.A.).

In both cases, the incorporation requires the granting of a public deed, and its registration at the Mercantile Registry. The regime on corporate agreements, corporate administration, books and records, annual accounts, audit reports and acts subject to be filed with the Mercantile Registry, are substantially similar for S.L. and S.A.

With respect to the formal requirements of the purchase of shares, it is important to notice the difference between these two types of companies. These differences are detailed below.

Private limited company (Sociedad Anónima)

The transfer of shares is different in the cases of registered shares and bearer shares.

- Registered shares do not have to be granted before a Public Notary or recorded at the Companies Register. Public limited company law states that once the managers of the company have checked the transfer of the shares, they have to record it in the Register Book of Registry Shares. Public limited company law also provides that the registered shares can be transmitted by endorsement.

- Transfer of bearer shares does not need to be granted before a Public Notary or registered. Only the title tradition is required, according to what is established in the Companies Code.

Should the transfer of any kind of shares imply the transformation into a sole partner company, this new condition has to be included in a public deed and recorded at the Companies Register according to the aforementioned law.

Limited liability company (Sociedad de Responsabilidad Limitada)

- The transfer of interests must be executed in a public deed granted before a Public Notary, and has to be registered at the Partners Register Book according to the limited liability company law.

- There is a pre-emptive right of purchase granted to the rest of the shareholders.

- Should the transfer of interests imply the transformation into a sole partner company, this new condition has to be included in a public deed and recorded at the Companies Register according to the aforementioned law.

Tax aspects

Transfer tax

Although exempt from both VAT and transfer tax in principle, under Spanish legislation, the acquisition of a property through a share deal can give rise to transfer tax, since the transfer of securities is subject to transfer tax at the typical rate of 7% under the following circumstances:

- When the transferred securities correspond to entities in which at least 50% of the assets are made up of real estate located in Spain.

- When, as a consequence of the transfer of the securities, the acquirer obtains, directly or indirectly, more than 50% of the capital stock.

Provided that such participation may be held directly or indirectly, for these purposes, transfers of shares in a holding company participating in a Spanish real estate company may give rise to transfer tax.

Increases of interest may also be subject to transfer tax.

Furthermore, the transfer of shares received as a result of a non-monetary contribution of a property within a term of three years after the contribution of the property will also be subject to transfer tax.

Transfer tax, when applicable to share deals, cannot be avoided by renouncing the VAT exemption.

It should be noted that the Spanish real estate transfer tax (RETT) rules for share deals have been subject to the scrutiny of EU institutions. In particular, the Spanish Supreme Court has recently referred a preliminary question to the ECJ to conclude on the compatibility of such rules with the VAT Directive and with the freedoms of establishment and movement of capital.

Building/rehabilitation of real estate

Legal aspects

Construction contracts

In Spain there are two types of construction contracts: public construction contracts regulated by the Law of Contracts of the State, or *Ley de Contratos del Estado*, and private construction contracts regulated by the civil code and/or the Building Act.

Public construction contracts are celebrated by public authorities and public entities that grant the construction of public works to a private company chosen by public tender. On the other hand, private construction contracts are celebrated between natural and/or legal persons, and are denominated as construction leases, or *arrendamiento de obras*.

The building rehabilitation

The duty of building rehabilitation was contained in the previous Urban Planning Laws, as well as the Urban Planning Law published by Spain in 1998, which is currently in force. Article 19 of this law states that the owners of any kind of construction must comply with the regulations related to rehabilitation that are developed by the regional and municipal authorities.

The rehabilitation is normally previewed for those constructions that have any cultural or historic value. In many cases, it is only applied to parts of constructions that are considered valuable by the zoning authorities. Notwithstanding, this duty can be applied to any kind of construction in case the competent authorities may consider it.

Tax aspects

Income tax

As stated in the Spanish domestic rules, construction, installation and assembly works, the duration of which exceeds 12 months, constitute a PE, and shall therefore be taxed as such. Nevertheless, when a tax treaty applies, its rules have to be examined, as they can introduce a different period of duration of the works in order to consider the existence of a PE in Spain.

Tax on construction, installation and building projects

This tax is levied on construction, installation and building projects and is applicable to the effective cost of the work. The taxpayer is the owner of the construction work, which is not necessarily the owner of the building. This tax is a deductible expense for corporate tax purposes.

The maximum tax rate will be 4%, depending on the municipality where the works are carried out.

Financial investments in Spanish real estate

Legal aspects

Changes in the regulations of the real estate investment companies and funds have made them more attractive for investors, provoking a significant increase of investments in this sector as well as the creation of new institutions.

Real estate investment companies are collective investment institutions that take the form of limited companies, *or sociedades anónimas*, which have the exclusive purpose of investing in urban real estate to be leased.

Real estate investment funds are collective investment institutions that have the exclusive purpose of investing in urban real estate to be leased. Real estate investment funds must be managed by a management company. The majority of the members of the board of the management company must be persons with proven experience in real estate and financial markets.

General notes on collective investment institutions

The minimum share capital of real estate investment companies is EUR 9,015,182.

The minimum equity of real estate investment funds is EUR 9,015,182. The minimum number of shareholders of real estate investment companies, and the minimum number of participants of real estate investment funds is 100, without counting those whose participations exceeds 25% of the institution's share capital.

Accordingly, with these rules, there are no limitations in the sense that an individual or entity may have a majority interest in a collective investment institution, provided that 100 shareholders' respective participations in the fund does not exceed 25% of the institution's share capital.

Transitory period concerning the investment policy

For newly incorporated collective investment institutions, and in respect of their investment policies, there is a transitory period of three years from its formal registration with the *Comisión Nacional del Mercado de Valores* (CNMV) in order to fulfil the legal requirements regarding the investment policy. Once this transitory period is completed, all the requirements regarding the investments in urban real estate must be fully completed or, if this is not the case, the entity could lose its legal consideration as a collective investment institution.

The applicable Spanish regulations concerning investments managed by these real estate investment institutions provide for several additional requirements to be observed during the transitory period. These requirements relate to such areas as investments in fixed income, or following rules of risk diversification.

Investment regime

Collective investment institutions must invest in urban real estate to be leased as dwellings, offices, commercial facilities, or students' and elderly residences.
In addition, these institutions can invest in real estate in construction phase, options, or real rights over real estate and administrative concessions that allow for the lease of real estate.

Real estate investment funds must invest at least 70% of their total assets in real estate. The rest of their assets can be invested in fixed income, although special requirements of liquidity must be met.

With each type of institution, no single property can represent more than 35% of the institution's total assets.

Properties that make up the assets of these entities cannot be sold during a three-year holding period, unless express authorisation of the CNMV is granted.

These entities can only carry out certain real estate promotions.

The borrowed funds of collective investment institutions cannot exceed 50% of the institution's total assets.

Restrictions on operations with directors, administrators, managers, participants and partners of these institutions

Restrictions exist relating to the purchase, sale or lease of the assets of real estate investment companies and real estate investment funds to their directors, administrators, managers, participants and partners. In addition, restrictions exist relating to the acquisition by these institutions of properties from companies of the same group, or which form part of the group of the management company.

Inspection and supervision

The CNMV shall inspect and supervise collective investment institutions to make certain they fulfil all legal requirements.

Tax aspects

General aspects

Resident shareholders or unitholders of these entities do not have to include in their personal income tax any income until the date these entities distribute their profits, or the date on which the interest owned is transferred by the shareholder or unitholder.

Dividends and profits distributed by these entities do not give any right to apply to its resident shareholders or unitholders any credit to avoid double taxation.

Real estate investment companies

Real estate investment companies, the exclusive social purpose of which is investment in urban real estate to be leased, are eligible for a low income tax rate of 1% if all the regulatory and tax requirements are met.

Real estate funds

The main differences between real estate funds and real estate investment companies are discussed above under the section '*Financial investments in Spanish real estate – Legal aspects*'. These funds are taxed in basically the same manner as real estate investment companies.

Mortgage securitisation funds

Mortgage securitisation funds are taxed following the standard income tax regime, but income received by the funds is exempt from withholding tax.

Spanish REIT: Sociedades Anónimas Cotizadas de Inversión en el Mercado Inmobiliario (SOCIMI)

Legal form and capital requirements

The only legal form that is permissible for a SOCIMI is a Spanish corporation (*Sociedad Anónima*). The nominal capital of a SOCIMI must amount to at least EUR 15m. There is a maximum threshold for external debt of up to 70% of the value of the SOCIMI assets.

Listing requirements

SOCIMIs must be listed on a recognised stock exchange in Spain, the EU, or the EEA.

No investment restrictions on shareholders

There are no specific provisions restricting the investment of shareholders into the SOCIMI. However, pursuant to the applicable stock exchange regulations a listed entity must have at least 100 shareholders with an interest of less than 25% each. In addition, a 25% free float is required.

Asset/income/activity tests

The corporate activity of the SOCIMI must be one of the following:(i) the acquisition and development of urban real estate for rent; (ii) the holding of shares in other SOCIMIs or in foreign companies subject to a similar REIT regime; (iii) the holding of shares in Spanish or foreign companies with the same corporate activity, dividend distribution obligations, leverage restrictions, asset and income tests as SOCIMIs; (iv) the holding of units in Spanish regulated real estate collective investment institutions.

At least 80% of the value of the assets must consist of qualifying real estate assets and shares. Qualifying assets must be held for a minimum period of three years, extended to seven years for self-developed real estate. In addition, at least 80% of the SOCIMI's earnings must relate to rent and dividends from qualifying shares.

Distribution requirements

The SOCIMI is obliged to distribute the following amounts:

- At least 90% of profits derived from rental income and ancillary activities.
- At least 50% of capital gains derived from qualifying real estate assets and shares. The remaining gain should be reinvested within a three-year period or fully distributed once the three-year period has elapsed and no reinvestment has been made.
- 100% of profits derived from dividends received from other SOCIMIs, foreign REITs, qualifying subsidiaries and collective investment institutions.

Tax treatment at SOCIMI level

The taxable base corresponding to the portion of qualifying income shall be subject to a 19% corporate tax rate as opposed to the standard corporate tax rate, which currently stands at 30%. All other income will be taxed at the standard rate. The SOCIMI's resident 100% subsidiaries may benefit from this tax regime.

A 20% exemption on income from residential property is available when the majority of the assets held by the SOCIMI are dwellings.

Tax treatment at the investor level

Dividend distributions by the SOCIMI both to residents and non-residents are not subject to Spanish withholding tax.

Non-residents and individual resident shareholders

Dividends derived from SOCIMI shares are exempt. Capital gains derived from the disposal of SOCIMI shares are partially exempt. The exemption is equal to 10% of the acquisition value of the shares multiplied by the number of years the shares have been held, less exempt dividends received during the holding period.

Non-residents with a PE and resident corporate shareholders

Dividends are subject in their entirety to corporate income tax at the general rate (30%). Those dividends distributed out of profits taxed at the reduced rate at the level of the SOCIMI are entitled to a tax credit to avoid double taxation equal to 19% (effective taxation of 11% at the level of shareholders). Dividends taxed at the general rate are entitled to the same tax privileges that apply to ordinary dividends. Capital gains derived from the disposal of SOCIMI shares shall be subject to the general income tax rate, i.e. 30%.

Transition to SOCIMI/Tax privileges

New or existing companies and collective real estate investment institutions can opt to join the SOCIMI regime by notifying the tax administration. The regime applies retrospectively from the beginning of the financial year in which the SOCIMI has validly applied to join the tax regime. There is no entry tax charge established for the transition to the SOCIMI regime.

Transfer tax, capital duty and stamp duty benefits may apply.

Delisting, waiver of the regime, substantial non-compliance with reporting requirements or dividend distribution obligations or any other requirements will result in removal from the SOCIMI regime.

Loss of the SOCIMI regime

If the company loses the REIT status, a new election for the SOCIMI regime to apply cannot be made for five years.

Financing the acquisition of Spanish property. Capital contribution and dividends

Legal aspects

Minimum share capital

One of the main differences between an S.L. and an S.A. is the minimum share capital required for their incorporation. For an S.A., the requirement is EUR 60,102 and minimum 25% paid up of each share. For an S.L., the requirement is EUR 3,006 and a minimum 100% paid up of each share.

Minimum debt/equity ratio

When losses reduce the net worth of an S.A. below two-thirds of the share capital at the end of two consecutive fiscal years, the company is obligated to reduce the share capital. This rule does not apply to an S.L.

When the losses reduce the net worth of the company – either an S.A. or an S.L. – below half of the share capital, the company is obligated to be dissolved, unless other measures, such as capital increase/decrease, or shareholders contributions are taken to recover the net worth of the company.

Tax aspects

Capital duties

The incorporation of a Spanish subsidiary is exempt from capital tax.

The incorporation of a Spanish branch would imply a 1% capital tax cost, provided that the head office is located in a non-EU country. The taxable base would consist of the funds formally allocated to the PE, or, if higher, the result of applying the proportion between the turnover of the Spanish PE and the total turnover of the head office to the fiscal capital of the head office as defined by Spanish legislation. This is defined as net worth excluding the results of the year.

Dividends

Regarding the distribution of dividends, 19% (21% in 2012-2013) of the gross amount should be withheld when paying them to a Spanish resident company or a company resident outside of the EU, in a country that has not concluded a double taxation treaty with Spain.

Otherwise, the applicable treaty should be consulted in order to determine the withholding tax rate applicable.

If dividends are paid to a company resident in a member country of the EU, and the company owns a direct stake of at least 5% in the capital of the subsidiary, and has one year of seniority, the provisions of the EU Parent-Subsidiary Directive apply. Because of this Directive there is no withholding on the dividends, provided the following conditions are met:

- Both companies are subject to direct taxation in the pertinent country of residence.
- The profit distribution is not the consequence of the liquidation of the subsidiary.
- Both companies take one of the forms provided in the Appendix to the EU Directive.
- The anti-abuse provision of the Spanish EU parent subsidiary regime is overcome.

The period of one year of previous seniority may be met if after that date the shareholder maintains the stake for a period of one year.

Debenture and interest

Legal aspects

The mortgage and other guarantees

The mortgage is a real and voluntary guaranty that guarantees the payment of a specific credit. The mortgage has to be duly drafted before a public officer and registered at the Land Registry in order to be duly constituted.

Spanish law contemplates a special procedure for the execution of the mortgage, which permits the creditor or third person to be the new owner of the plot in approximately no more than one year, by public tender.

There are other kinds of guarantees, such as the right of distraint, susceptible to be recorded at the Land Registry. This right guarantees the performance of certain obligations. These guarantees are compulsory for the owner of the plot or premises by a judge resolution, and for its execution the actor has to follow the Spanish customary procedures established in law.

Tax aspects

Income tax

Interest tax deductibility: Transfer Pricing

Assuming that loans are granted at arm's length basis, the deductibility of interest depends on the way the investment in Spain is to be made.

- In the case of direct investments, interest paid on loans taken out to acquire property, would be deductible as long as they are directly related to the income obtained in Spain and the taxpayer can provide supporting evidence that this is the case.

- In the case of investments through a PE or Spanish subsidiary, interest paid by virtue of a loan agreement contracted for the acquisition of real estate is, for corporate tax purposes, in principle fully deductible, provided that the parties met the arm's length principle. However, the PE cannot deduct interest paid to its foreign head office, except under a provision of a tax treaty that may allow such deduction.

Furthermore, when interest is paid to any of those countries or entities considered as a tax haven for Spanish tax purposes, deductibility depends on the proof that the loan is needed for the activity, and that the conditions established respect the arm's length basis rules.

New transfer pricing rules are applicable for tax periods starting as of December 2006. Documentation regulations shall be observed.

Withholding tax on interest

Interest payments made by a Spanish debtor – be it a company or PE – to a non-resident in consideration of a loan or current account is, in principle, subject to a 19% withholding tax (21% in 2012-2013), unless provided otherwise by a tax treaty. In this case the tax rate generally ranges between 0% and 10%. However, Spanish domestic law provides for a withholding tax exemption on interest paid if the lender is an EU entity without the involvement of a PE. A certificate of tax residence in the EU must be provided by the lender to the Spanish payer of the interest in order to avoid the withholding on the payments.

Financial expenses-capping rule

A new financial expenses–capping rule replaces the Spanish thin capitalisation provisions with effects to financial years starting on or after 1 January 2012.

The financial expenses-capping rule will limit tax relief for net financial expense to 30% of the operating profit.

The key points of this new rule are as follows:

- The restriction applies to any debt, including intra-group and third party debt.
- The basis of the 30% limitation is applied to the accounting operating profit after deducting (i) depreciation of fixed assets, (ii) subsidies for non-financial assets and others, (iii) impairment and transfer of fixed assets, and adding (iv) financial income from certain equity instruments.
- The net financial expense of the year up to EUR 1m shall be treated as tax deductible. This means that the 30% capping only applies to amounts exceeding the EUR 1m threshold.
- The EUR 1m minimum threshold should be reduced proportionately for tax periods of less than 12 months.
- Financial expenses disallowed can be carried forward for 18 years, increasing the interest expense in the subsequent years, which will be subject to the 30% limit.
- If financial expenses do not reach the 30% breakdown, the difference may be carried forward to the following five years for tax deductibility purposes.
- The financial expense capping-rule will not be applicable to banks and insurance entitites.
- This new rule does not preclude the application of the transfer pricing provisions to related party transactions.
- The new law establishes specific provisions for tax unities.
- The limitation is not applicable in the period when the entity is extinguished.

On the other hand, financial expenses derived from intra-group debt used to fund the acquisition of interests in entities from other group companies, or for equity contributions to group entities, will not be treated as tax deductible unless such transactions are business driven.

Profit participating loans

The participating loans may be considered a variety of subordinated loans, which are those by virtue of which the creditor expressly waives their priority in rank for the benefit of other creditors. Participating loans will be deemed as accounting net worth regarding capital decreases and winding-up of companies for the purposes of the mercantile legislation.

According to Royal Decree Law of 7 June 1996, profit participation loans must necessarily have the following features:

- The loans must provide to the investor a variable interest determined on the evolution of the activity of the business. The criteria to determine the said evolution may be profits, level of revenues, net equity of the borrower or any other criteria established by the parties linked with the evolution of the borrower business activity.

- Early repayment must be penalised if agreed to by the parties. On the other hand, the anticipated amortisation of the participating loan will require an equivalent increase of the net equity of the company.
- Spanish company law subordinates creditors of participating loans to all common creditors, except the shareholders of the company when such company is liquidated.

Additionally, it is essential that there must exist an obligation that the borrower repay to the investor the funds granted, in order to determine the loan's nature as debt and not as equity.

In the case of profit participation loans granted by a non-resident-related entity, financial expenses capping rules would also apply, and the fixed and variable interest paid by the Spanish subsidiary or PE should meet the arm's length principles to preserve the interest's deductibility and be duly documented.

In this respect, it must be noted that, participating loans are considered as equity for purposes of debt/equity balance. Therefore, they represent a useful tool to rebalance debt/equity ratios for commercial purposes.

Subordinated loans

Although commonly used by banks and credit entities, loans referred to any other particular issue, different to the evolution of the business as a whole, are not expressly regulated in Spanish legislation. Therefore, we should attend standard rules for its deductibility (market rates, financial expenses capping rules, tax-havens regime, transfer pricing).

Stamp duty on real estate mortgages

When a mortgage loan is entered into in order to finance property, a stamp duty is levied at a rate of 0.1% to 1.2%. No stamp duty is levied on any other kind of loans, even participating loans or any other kind of debt instrumented in securities, provided that they are not secured by a mortgage.

Real estate financial leasing

Legal aspects

Leasing contracts are regulated by the Law of Discipline and Intervention of Credit Entities, or *Ley de Disciplina e Intervención de las Entidades de Crédito*, which defines these types of contracts. These types of contracts can be used both for personal property and real estate.

According to this type of contract, the financial leasing entity owner of the premises or plot leases it to another person, and gives that person an option to buy at the end of the term of the lease. The contract discounts from the final price the rents already paid by the lessee in cases where the lessee exercises its option to buy.

This type of contract can be recorded at the Land Registry to have validity before third parties.

The accounting treatment for the lessee of a lease with a purchase option will depend on whether the purchase option is reasonably expected to be executed or not, according to the economic conditions of the lease contract.

Only when the purchase option is reasonably expected to be executed by the lessee, will the special accounting rules applicable to the lessee coincide with what is commonly known as a finance lease.

Otherwise, if the purchase option is not reasonably expected to be exercised by the lessee according to the economic substance of the agreement, the lease will have to be registered by the lessee according to the rules corresponding to standard renting.

Under Spanish corporate tax legislation, in a leaseback operation the transferred asset will continue under the same depreciation regime as before the transfer, as if the transfer had not taken place.

Tax aspects

Income tax

Resident or non-resident with a Spanish PE

The part of the leasing instalments which correspond to the recovery of the cost of the goods will be considered as a tax-deductible expense for the lessee, except if the contract covers lands, sites or other non-depreciable assets. The lessee will likewise obtain tax relief from the financial charge paid to the lessor entity.

The amount of this tax deduction may not exceed the result of applying twice the straight-line depreciation coefficient that corresponds to the leased assets in accordance with the official approved depreciation tables. Accordingly, the leasing tax regime provides an accelerated depreciation regime, consisting of double the standard depreciation. For companies with a medium or reduced size, the accelerated regime may rise to triple the standard depreciation corresponding to the asset.

In order to enjoy this regime, the leasing contract must fulfil the following requirements:

- The leasing contract must be carried out with a leasing financial entity as defined in the Law of Discipline and Control of Credit Entities.
- The leasing contract must have a minimum term of two years when they cover movable goods, and of ten years when they cover real estate or industrial establishments.
- The financial leasing instalments must be expressed in the respective contracts in such a way that they differentiate between the part that corresponds to recovery of the cost by the lessor entity and the financial charge required by the said entity.
- The annual amount of the part of the leasing instalments corresponding to recovery of the cost must remain equal or increase throughout the contractual period.

Non-residents without a Spanish PE

Payments made by a Spanish resident lessee to a non-resident lessor without a PE in Spain, for the lease of real property, under both operating and finance leases, will be subject to withholding tax in Spain. This withholding tax is at the general rate of 24% established for non-residents (24.75% in 2012-2013).

However, if the lessor were deemed to have a PE in Spain in connection with the leasing activity, the above-mentioned payments would be subject to the general corporate income tax rate of 30%, corresponding to resident taxpayers.

VAT

As a general rule, any leasing of assets –residential excluded- carried out by VAT taxpayers will be subject to VAT at the general rate of 18% (21% effective from 1 September 2012). In this case, the lessor entity will be required to charge VAT to the buyer.

VAT will accrue when the periodic instalments became binding, on the amount of the instalment in question.

Managing Spanish real estate

Corporate income tax: Resident entities and non-residents with a PE

Resident entities and non-resident entities with a PE are taxed, in general terms, at a 30% rate on the net income, which is calculated following the principles of the Spanish accounting plan.

In particular, the following expenses are tax-deductible if properly documented:

- Interest expenses, provided that the financial expenses capping and transfer pricing rules are respected. (PE cannot deduct interest paid to its foreign head office.)
- Operating expenses
- Maintenance expenses
- Property management expenses
- Property valuation fees
- Legal fees
- Tax advice
- Audit fees
- Management fees, provided that a prior written agreement exists, showing the method of distribution of the expenses under rational criteria
- Capitalisation of expenses and interest incurred in acquiring the property

Other expenses in addition to the acquisition price, such as those arising from demolition, insurance, installations, etc., incurred prior to the entry in operating conditions of the property, can be considered part of the acquisition price, and amortised, instead of considered expenses.

Furthermore, interest related to the acquisition of the real estate, accrued up to the same moment, can also be capitalised.

Tax depreciation regime of real estate assets

With the exception of land, and the capitalised expenses related to land, most tangible and intangible fixed assets are depreciable for Spanish resident companies, foreign companies acting under a PE, and both national and foreign individual entrepreneurs. However, the depreciation rules as described below do not apply to property held as inventory.

The tax depreciation method generally used for building depreciation is the straight-line method. The original acquisition costs, i.e. the acquisition cost itself plus related expenses, such as registration duties, brokerage fees, notary's fees, architect's fees, betterment, etc. are the basis for depreciation. As a general rule, 2% is the straight-line depreciation rate acceptable for commercial properties such as office buildings; 3% for industrial properties. This rate can be doubled if the property is acquired already used, or other rates can be used if an agreement is reached with the tax authorities. However, if it can be substantiated that the useful life of the property is shorter, a higher depreciation rate may be applied. This is normally achieved by means of special depreciation plans to be agreed with the Spanish Revenue.

Plants and machinery can be depreciated at a higher rate, where they can be considered as a differentiated part of the immovable property. These items are considered as such when they can be separated from the property with no major alteration of the latter.

Costs and expenses derived from the acquisition, such as transfer tax, or notary fees, for instance, can be, generally, computed as acquisition value, and therefore depreciated as well.

Impairments of real estate assets

When the market value of a property, regardless of whether it is considered as a fixed asset or inventory, falls below its acquisition price, or production cost, the accounting value can be adjusted with the pertinent provision, if reversible. Such an adjustment is also considered as tax-deductible, provided that it is duly recognised in the annual accounts, and the difference between acquisition/production value and market value at the end of the financial year can be proved to the Spanish tax authorities.

Personal income tax

As mentioned previously, income derived from the letting of property in Spain held by individuals is subject to taxation in Spain, but the basis depends on the consideration of individuals as resident or non-resident in Spain.

Income from immovable property obtained by a resident individual will be subject to Spanish personal income tax at a maximum progressive rate of 52% in 2012-2013.

In the case that real estate income, could be considered as business earnings, corporate tax rules should be applicable.

Withholding tax on rents

Income obtained from the lease of urban property is subject to withholding, in principle, and the lessees are required to make the relevant withholding of 19% from the rent paid (21% in 2012-2013). However, the lessee will not be required to withhold any amounts from this income if any of the following requirements are met:

- The annual rent paid by the lessee to the lessor does not exceed EUR 900.

- The rent is paid by a company for the renting of a dwelling at the disposal of its employees.
- The lessor is obliged to pay a business tax, as explained below, on professional and business activities. This would be the case when the cadastral value of the leased property is equal to or greater than EUR 601,012.10. In this case, the lessor must prove such circumstances to the lessee.
- The rents are due to financial leasing contracts of urban properties according to the Law of Discipline and Intervention of Credit Entities.

Non-resident entities without a PE

Non-resident entities without a PE are taxed, accrual by accrual, at a 24% rate on certain net income (24.75% in 2012-2013).

VAT

The letting, financial leasing and granting of surface or rights *in rem* on commercial property, such as office buildings, shopping centres, business facilities, etc. is subject to Spanish VAT at the general rate of 18% (21% effective from 1 September 2012).

However, the letting of property for housing purposes is exempt from VAT.

In cases where a VAT taxpayer lets different types of property so that they carry out both VAT-able and VAT-exempt letting of property, the partial deduction rule regime will be applicable.

Spanish VAT due on supplies and services rendered by non-established VAT taxpayers to an established Spanish VAT taxpayer is levied upon the established Spanish VAT taxpayer recipient of the supply or service. This is the reverse charge rule.

Business tax

Any business developed in Spain is subject to business tax, levied on a yearly basis. The business tax cost will depend on the specific activity carried out by taxpayers. Office/commercial facilities renting activity tax charge is 0.10% of the cadastral value of the leased surface within the national territory. If the total cadastral value is lower than EUR 601,012.10, no business tax shall be charged under this concept.

Taxpayers with an annual turnover under EUR 1m (according to the last corporate income tax return filed) and individuals are tax-exempt. In addition, the first two years of activity are also exempt.

Business activity tax is deductible for corporate tax purposes.

Real estate tax

Real estate tax is levied on an annual basis and the tax rates may range from 0.4% to 1.10%, applicable to the cadastral value of urban properties, and 0.3% to 0.9%, applicable to the cadastral value of non-urban properties. However, such rates are increased or decreased by the local authorities, depending on the specific location of the property.

The taxpayer of this tax is the owner. Notwithstanding the above, this tax is commonly charged to the tenant if so agreed. Real estate tax is deductible for corporate tax purposes.

Special tax on real estate owned by non-residents

A 3% tax is levied on a yearly basis on the cadastral value of real estate owned by non-residents. This value is reviewed periodically.

However, this tax is not levied under certain circumstances, as described below.

- When the properties are owned by listed companies on official secondary stock markets.
- When the properties are owned by entities entitled to benefit from a tax treaty with a clause of exchange of information, provided that the ultimate individual owners of the properties are either entitled to benefit from a tax treaty with a clause of exchange of information or resident in Spain. Such circumstances will have to be proved through appropriate tax residency certificates.
- When the properties are owned by foundations and non-lucrative entities registered in a country with a tax treaty with a clause of exchange of information entered with Spain.
- When the properties are owned by foreign states, public institutions or international bodies.
- When the properties are owned by non-resident entities that develop in Spain an economic exploitation different from the mere leasing of the real estate.

This tax does not apply when the real estate is owned by a Spanish company, even when this company is totally owned by non-residents. It is open to discussion if the application of this tax to EU companies is compatible with EU Law.

It should be noted that a bill under discussions is proposing that all entities would be exempt from this tax with the exception of those entities resident in certain prescribed jurisdictions.

Transferring real estate

Legal aspects

The transfer of a real estate property by a non-resident

The transfer of real estate property by a non-resident needs to meet the same conditions and formal requirements as a transfer by a resident. Accordingly, there are two different formal ways to accomplish a transfer. The first is by private contract, effective only between the parties, taking into account that private contracts cannot be registered at the Land Registry. The second is by a public deed granted before a Public Notary to be later registered at the Land Registry, which is fully effective before third parties. For this reason, it is recommended that parties follow this second option.

These types of contracts must include all legal requirements established in the civil code for the transfer of property.

According to the Royal Decree 9/2005 of 14 January 2005, concerning soil pollution, when the transfer of a property (or the transfer of a right over a property) is granted by means of a public deed and potentially polluting activities have taken place in the transferred property, the owners will be obliged to declare this fact in such deed.

Likewise, when an administrative decision has been adopted stating that a specific property is polluted, this decision will have to be stated in the Property Registry.

On the other hand, and also when the transfer of property is granted by means of a public deed, pursuant to the legislation regarding the prevention of money-laundering activities, the means of payment and the data concerning the origin of the funds (account number, cheque, etc.) shall be stated in the Public Deed and a proved copy of the bank cheque or accreditation of the money transfer (or any other kind of money order) will be enclosed to the deed.

The transfer of shares in a non-resident real estate company

The transfer of shares in a non-resident real estate company does not imply the transfer of real estate assets, because there is only a change of partners. For this reason, it is not necessary to celebrate in Spain a private contract or to grant a public deed of transfer of real estate property. The owner of the properties recorded at the Spanish Land Registry will be the same after the purchase of shares of the real estate company.

Tax aspects

Capital gains taxation

Resident entities

Capital gains realised by a Spanish resident company on the transfer of Spanish property are subject to Spanish corporate tax. Capital losses realised on the transfer are fully deductible. The capital gain or loss realised on the disposal of the property is calculated as the proceeds less the tax book value of the property, i.e. historic cost less tax depreciation, taking also into account the relevant inflation adjustments.

The current term for tax loss carryforward is 18 years. Newly incorporated companies can compute such term from the first tax period in which profits are obtained.

The capital gains derived from the transfer is subject at the standard rate of 30%. However, it may be reduced to an effective 18% tax rate through a 12% tax credit, provided that the property is considered a business asset rather than inventory, and the company meets the reinvestment conditions established by the law. These conditions, among other circumstances, require the reinvestment to be made within a term of one year prior to the disposal of the property or three years after the said disposal.

Resident individuals

Under Spanish personal income tax rules, the amount of the capital gains or losses shall be determined by the difference between the acquisition and transfer values, taking also into account the relevant inflation adjustments, in the case of capital gains stemming from the disposal of real estate.

Capital gains obtained in the transfer of real property are taxed at a flat rate of 19% (21% on the amount exceeding the EUR 6,000 threshold). For years 2012 and 2013, rates have been increased (in tranches): 21% for gains up to EUR 6,000, 25% between EUR 6,000 to EUR 24,000, 27% for gains above EUR 24,000).

Furthermore, the taxation of capital gains arising in connection with assets bought before 31 December 1994 can be reduced, depending on the acquisition date.

Non-resident entities and individuals

Transfers of Spanish properties by a non-resident entity without a PE are subject to a 19% tax on the capital gain (21% in 2012-2013).

If a PE exists, capital gains would be added to the non-resident income taxable base, and netted against expenses and capital losses, if any.

Under Spanish domestic legislation, capital gains derived from the disposal of Spanish companies, the main assets of which consist of real estate, are taxable in Spain at a 19% rate (21% in 2012-2013). However, under certain tax treaties, such taxation can be avoided.

This treatment is also applicable to the sale of participation on real estate funds or companies.

Under both direct and indirect investment structures, the taxation of capital gains obtained by non-resident individuals in connection with assets bought before 31 December 1994 can be reduced, depending on the acquisition date of the asset.

Special regime for mergers, spin-offs, contribution of assets and exchange of securities

There is a special tax-free regime available when transferring properties, or real estate companies, as a result of some corporate operations, such as mergers, spin-offs, contribution of assets and exchange of securities.

For these cases, it is required in general terms that the acquiring entity is a Spanish-resident entity, and it is forcedly to be notified to the Spanish tax authorities.

It should be noted that Spanish law goes further than EU disposals regarding neutrality in corporate operations, and grants the regime also to mere contributions in kind made by a non-resident to a Spanish-resident company.

As a result, it is also available for planned structures in which subsequent transferring of shares, instead of properties, is preferred, provided that the operation as a whole does not attempt against the corresponding anti-abuse, such as fraud or tax evasion, provision.

Special 3% withholding on real estate transfers

When a non-resident without a PE in Spain is transferring a property located in Spain, the acquirer, regardless of whether they are resident or not, will become obliged to withhold 3% of the price, on the account of the transferor's income tax.

If the property is transferred by an individual, a reduction of taxation will be applicable if it is acquired before December 1994.

This 3% withholding does not apply on the transfer of the shares of Spanish real estate companies made by non-resident shareholders.

VAT/real estate transfer tax

The same comments included in the section '*Direct purchase of assets – Tax aspects*' are applicable here in connection with the indirect taxation of assets.

Revision period for VAT deduction regarding real estate assets

Under Spanish VAT legislation, a property is subject to a so-called revision period. The revision period is ten years, i.e. the calendar year in which the property is put into use and the subsequent nine calendar years. In the year in which the property is put into use, the VAT will in principle be recoverable according to the ratio between the turnover from VAT-able supplies and the total turnover of the taxpayer.

At the end of each following year a comparison must be made between that year's ratio and the ratio of the acquisition year. If the ratios differ, either additional VAT payment must be made, or a VAT refund will be received by the owner of the property. However, if the ratios differ by 10% or less, no additional payments will be made. When property is transferred during the revision period, a VAT adjustment may be required. For that purpose, 10% of the original VAT paid is notionally allocated to each year of the revision period.

Regarding the VAT consequences of the transfer of the property during the revision period, the following rules apply.

- If the transfer is not subject to VAT (with the exception of the transfer of a going concern), then a legal fiction assumes that the property has only been used by the seller for tax-exempt activities during the remaining part of the revision period. The input VAT, at an amount of 10% per year, allocated to this remaining period, cannot be recovered by the seller. If this VAT has already been recovered by the seller in previous years, a one-time adjustment payment must be made by the seller to the tax authorities for the remaining part of the ten-year period.

- If the transfer is subject to VAT, then a legal fiction assumes that the property has been used by the seller for taxable activities during the remaining part of the revision period. The input VAT, at an amount of 10% per year, allocated to this period can be fully recovered by the seller.

Regarding the ten-year revision period, a new computing will start for the buyer of the property, following the VAT-able transfer of a property.

Municipal tax on increase in value of urban land

This local tax will accrue upon the transfer of urban land. The taxpayer is the seller. The economic consequences of this tax could be relevant, depending on the date of acquisition of the land transferred.

The maximum tax rate will be 30%, depending on the municipality where the real estate is located. This tax rate is applicable on the deemed increase in value calculated on the cadastral value of the land taking into account the coefficients included in the tax ordinances. The tax on increase of value of urban land is deductible for corporate tax purposes.

Sale of shares in Spanish resident entities

Under Spanish domestic legislation, capital gains obtained by non-residents from the disposal of shares of Spanish companies for which their main assets consist of real estate are taxable in Spain at a 19% rate (21% in 2012-2013). However, under certain tax treaties, such as with the Netherlands, the UK, and Austria, for instance, such taxation can be avoided.

Conclusion

As in any other investment, the fixing of an optimal investment structure for real estate acquisition, exploitation or transfer will depend on the specific objectives of each investor.

Before investing in Spanish real estate, it is highly advisable for the investor to check the burdens on the property, and whether it is eligible for the use towards which it is intended.

Obviously, the optimal solution might vary from passive to active investments, from long-term to short-term expectations, or even depending on the residence of the investor or the financial tools available.

Apart from direct taxation considerations, some other very different aspects should be borne in mind prior to investing in Spanish property, such as the following:

- VAT recovery
- Possibility of option to VAT if VAT exempted
- Transfer tax
- Taxation on share deals, when acquiring or transferring
- Financial expenses capping rule
- Transfer pricing
- Repatriation of funds

Contacts

Advisory

Guillermo Massó López
Tel: +34 91 568 4353
E-mail: guillermo.masso@es.pwc.com

Juan Velayos
Tel: +34 93 253 2540
E-mail: juan.velayos.lluis@es.pwc.com

Assurance

Gonzalo Sanjurjo
Tel: +34 91 568 4989
E-mail: gonzalo.sanjurjo.pose@es.pwc.com

David Calzada Criado
Tel: +34 91 568 4807
E-mail: david.calzada@es.pwc.com

Tax

Antonio Sánchez
Tel: +34 91 568 5615
E-mail: antonio.sanchez.recio@es.pwc.com

José L. Lucas
Tel: +34 91 568 5607
E-mail: jose.luis.lucas.chinchilla@es.pwc.com

Legal

Javier García Camacho
Tel: +34 91 568 4209
E-mail: javier.garcia.camacho@es.pwc.com

Yohana Calachi Vavrinova
Tel: +34 91 568 5312
E-mail: yohana.calachi.vavrinova@es.pwc.com

Paula Hernández Lemes
Tel: +34 91 568 4290
E-mail: paula.hernandez.lemes@es.pwc.com

www.pwc.com