Investing in Spanish Properties

General Overview

STEP SEMINAR – London, 3 July 2007

Avantia
family office

1. Most Common Investment Structures

Most common structures for investments by non-Spanish citizens in Spanish real estate:

• Direct investment in Spanish properties

• Investment through a Spanish company (usually a “Sociedad Limitada” or SL)

• Investment through a double tier structure (usually a EU vehicle with shares in a Spanish SL holding the real estate)

2. Direct Investments by Individuals

• Obtaining verification of the legal status of the property from the relevant Property Register

• Usually there are some down payments made during the verification process, by virtue of a private agreement between the parties

• Formal acquisition instrumented by means of a public deed granted before a Spanish public notary:

- Dates and legal title
- Full registration details
- Identities of buyer and seller
- Means of payment

• If the acquisition is financed through a mortgage, this will be formalised by means of a public deed. It is recommended to take up a mortgage with an entity operating in Spain, to ensure deductibility of the debt for Wealth Tax and Inheritance Tax purposes

2. Direct Investments by Individuals

- Indirect taxes: either VAT at 7% plus Stamp Duty, generally at 1%, on direct acquisitions from property developer or Transfer Tax, usually at 7%, otherwise

- If the seller is non resident, withholding tax at 3% of the proceeds will need to be withheld by the buyer and paid over to the Spanish tax authorities

- Once the deeds, including any mortgage deeds, are executed, they are submitted to the relevant Property Register for registration

3. Investment through a Spanish Company

- If a new company is being formed:

  - Need to obtain name clearance from the Mercantile Register
  - Minimum share capital for a SL: €3,006, fully paid up
  - Need to appoint administrator/Board of Directors
  - Stamp Duty payable equal to 1% on share capital plus share premium, if any
  - Real estate acquisition procedures as per 2 before

- If the object of the transaction is the purchase of shares in a Spanish SL with the underlying investment:

  - Prior due diligence strongly recommended, for legal and tax purposes
  - Verification of legal title to the underlying property through the relevant Property Register
  - Share transfers in SLs must take place by virtue of a public deed granted before a public notary
  - By application of the Spanish anti-avoidance provisions on indirect taxes, transfer tax will become payable by reference to the market value of the underlying property, generally at a rate of 7%

Avantia family office

4. Investment through Double Tier Structures

- If a new structure is being formed:

  •Set up procedures at top tier level will need to be complied with, and cash injected into the structure
  •Company incorporation procedures in Spain as per 3. above
  •Procedures for purchase of underlying property as per 2. above

- If the object of the purchase is a pre-existing structure:

  • Prior due diligence strongly recommended, for legal and tax purposes, at all tiers of the structure
  • Verification of legal title to the underlying property through the relevant Property Register
  • Share transfer must take place in accordance with the procedures of the jurisdiction of the top tier vehicle
  • By application of the Spanish anti-avoidance provisions on indirect taxes, transfer tax could become payable by reference to the market value of the underlying property, generally at a rate of 7%
  •Past risks, particularly of a Spanish tax nature, may be covered by lowering the price or by withholding part of the proceeds on escrow accounts

5. Main Spanish Tax Implications of Direct Real Estate Investments by Non Residents

- Annual tax liabilities on unlet properties will include:
  - Municipal taxes, based on cadastral values
  - Income tax of 24% on deemed income accrued (generally 2% on cadastral values)
  - Wealth tax on the net value of the property (generally acquisition cost less outstanding mortgage at 31 December). A €500,000 property with no mortgage held by a couple would trigger an approximate total liability of €1.2K per annum
- An eventual disposal of the property would generate a capital gains tax charge on the gain taxable at a 18% flat rate
- Donation of the property would trigger both a taxable gain in the hands of the donor and an inheritance tax charge in the hands of the donee
- Inheritance of the property would trigger an inheritance tax charge in the hands of the heir on the market value of the property, net of mortgages, and taxable at the progressive tax rates

6. Main Spanish Tax Implications of Property Investments through a Spanish Corporate Vehicle

• Unlet properties owned by a Spanish company, used by related parties will generally generate deemed income by application of the transfer pricing provisions. Taxable profits will become chargeable to Spanish corporation tax at the applicable rate (25% for small companies, 30% standard rate from 2008 onwards)

•Deemed dividends might also accrue by application of the new transfer pricing regulations

•Disposal of the properties by the Spanish company would generate a taxable gain for corporation tax purposes, taxable at the applicable rate. If the disposal took the form of a share transfer by the individual, there would be a 18% tax charge on the resulting gain

•Individual shareholders would become liable to Spanish wealth tax on an annual basis, generally on the Net Book Value of the shares in the Spanish company

•Donation of the shares would trigger both a taxable gain in the hands of the donor and an inheritance tax charge in the hands of the donee

•Inheritance of the shares would trigger an inheritance tax charge in the hands of the heir on their market value, and taxable at the progressive tax rates

7. Main Spanish Tax Implications of Property Investments through Double Tier Structures

- General advice: avoid vehicles in tax havens/zero tax jurisdictions in order to escape the deemed residence provisions and mark-to-market rules on future disposals
- Spanish tax implications of the Spanish vehicle as per 6. above
- Need to ascertain whether or not the shareholders will need to appoint a Spanish tax representative under the new provisions
- Main advantages: if properly structured:
    - No Spanish wealth taxes would be levied
    - There would be no Inheritance tax charge on eventual successions
    - The disposal of the property could be instrumented by a transfer of shares in the Spanish company, free of Spanish capital gains tax