Spanish Real Estate Legal Update

Review

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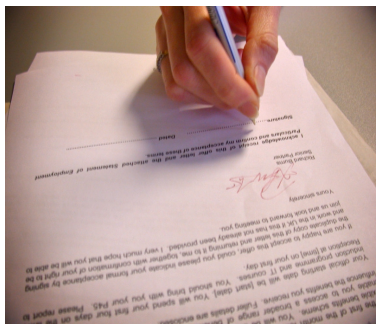

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New tax information obligations for landlords of commercial premises.

On the 9th February 2011, the Sub-directorate-General for Tax Technique issued a release increasing the information obligations on form 347 regarding the declaration of operations with third parties. These include the obligation for landlords of commercial premises to declare leasing operations of over 3005.06 euros carried out in the previous calendar year.

Previously, landlords were exempt from complying with the obligation to provide information (form 347) for all commercial leasing agreements providing income of over 3005.06 euros per year, if these leasing agreements had already been subject to tax and duly declared by the lessee. This exemption was due to the fact the lessees had already duly informed the Tax Office of the existence of the agreements in the tax returns corresponding to their payments deductions (form 180), and was aimed at avoiding duplicate information.

From this year onwards, the modification to the aforementioned exemption is applicable, with landlords now being obliged to declare operations relating to the premises with an income of above 3005.06 euros per year. The argument given by the Treasury is that the form 180, completed by the lessees, does not give the property registration number and the that landlords are required to provide with it.

We do not wish to evaluate whether or not this new requirement is necessary, but one may consider that said property reference number could be obtained by simply adding a new box to form 180, rather than imposing new obligations on landlords.

Landlords' failure to comply with the aforementioned obligation may lead to sanctions that could include a monetary fine, as established in the General Tax Law, of between 300 and 20,000 euros.

Javier Berreteaga

Mortgage enforcement procedure and the adequacy of the handover of the mortgaged property as payment for the sum total of amounts owed.

By virtue of the decision no. 111/2010, dated 17th December 2010, of the Provincial Court of Navarra, permission to seize other assets belonging to a debtor for the sum of the debt not covered by the auction of the mortgaged property was denied. The request to seize the other assets was based on the fact the auction was declared absent of qualifying bids and the property was, therefore, awarded to the bank for an amount below that of the valuation in the mortgage deed itself, signed by both parties. This resulted in an amount that was lower than the debt to be paid.

Although this decision has recently been revoked by the Third section of the Provincial Court of Navarra (for reasons detailed below), it has served as a benchmark for other rulings in similar cases, such as the decision no.44 dated, 4th February 2011, of the Barcelona Court of First Instance, which has given rise to several controversies regarding whether it is adequate or not to hand over the mortgaged property to cover the sum total of the existing debt, even when the value placed on the property in the auction is lower than the amount owed.

An analysis of the arguments given in these rulings for not proceeding with the seizure of other assets belonging to the debtor to cover the difference not covered by the mortgaged property sold at auction, and the rulings against it, reveals the following:

Firstly, we must look at the doctrinal arguments that have arisen regarding the existence or not of an infringement of rights, in the request for the seizure of other assets to the value of the pending debt.

Part of the doctrine states that as, according to both Article 1911 of the Civil Code on universal liability (that establishes that the debtor is liable to fulfil his / her obligations with all present and future assets) and Art. 579 of the Civil Procedure Law which allows the creditor to proceed with the seizure of the debtor's other assets in the event of the result of the auction of the mortgaged or pledged property being insufficient to cover the loan, such a request does not constitute an infringement of legal rights.

However, the argument of those in favour of not proceeding to seize the other assets of the debtor, considers that the stipulations of the aforementioned precepts are not always applicable, given that the enforcement is aimed at satisfying the creditor via the seizure of the property provided by the debtor (and accepted by the creditor) as a guarantee of compliance with the obligations of the contract. Therefore, after the auction and sale of the mortgaged property, the procedure should be deemed finished.

Furthermore, they state that, in compliance with Article 3 of the Civil Code, the regulations must be applied according to the reality at the time of application. Therefore, although the application of the aforementioned regulations does not constitute an infringement of rights, it is morally objectionable for the creditor to claim that the property provided as a guarantee has decreased in value when, if this had been known beforehand, the loan would not have been granted.

As a response to these allegations it may be considered that, regardless of any personal opinion the aforementioned precepts may give rise to, the judge is not responsible for carrying out the duty of the legislator, but for applying the law in the specific case. Not applying the rules affects the very principle of legal certainty in that it alters the legal framework that was in place when the operation was carried out and the foundations of the mortgage guarantee system in Spain. This can cause significant repercussions of a more practical nature that are not linked to the Law.

Neither can it be claimed that creditors are acting with manifest infringement of rights if they demand the remaining amount of the loan from the debtor, when the seizure has not provided the amount required to cover the total sum. The only case where this could apply is if the agreement was subject to Article 140 of the Mortgage Law on limited mortgage liability. This Article provides an exception to the stipulations of Article 105 of the same Law, and establishes the debtor's liability and the creditor's enforcement action as the sum of the mortgaged property, leaving the other assets out of reach of the creditor, if this agreement has not been made in the mortgage deed, in accordance with Article 105 of the same Law, the mortgage does not alter the unlimited personal liability of the debtor.

Lastly, regarding the possible existence of unjust enrichment on behalf of the enforcing creditor by the sale of an asset at a price considerably lower than the appraised value of the property, one school of thought argues that no claim of unjust enrichment can be made if the mortgage enforcement was carried out in accordance with the law.

In general terms, the analysis of the aforementioned positions, and the controversy that has arisen as a result of the decision of the Provincial Court of Navarra, leads us to conclude that we will have to wait for the High Court to resolve the situation, which could even result in the Mortgage Law being modified in line with the wishes of some sectors.

Sandra Paoletti

Possible future tax in Spain on capital gains obtained by German companies in transfers from their Spanish subsidiaries whose assets are mainly comprised of real estate assets.

With the occasion of the Spain - Germany summit in February, both countries have signed a new agreement to prevent double taxation with regards to Income and Property Tax, significantly modifying the existing agreement.

The new agreement will replace the previous one signed in 1966 and, according to the Treasury, it will be adapted to new commercial requirements as well as to the various changes that have been made to the OECD model agreement:

The main difference in the new agreement is the tax on capital gains and the State where these taxes can be paid.

Article 13 of the 1966 agreement, stipulates that capital gains obtained through the transfer of real estate assets can be subject to tax in the State where said real estate asset is located.

For the purpose of defining the concept of immovable assets, Article 6 of the 1966 agreement refers to them as those that are defined as such in the law of the State where they are located.

Regarding moveable assets, the aforementioned agreement stipulates that their transfer may only be subject to taxation in the State of residence of the transferring party, regardless of the location of these moveable assets. As an exception to this, the 1966 agreement also stipulated that the capital gains obtained in the transfer of moveable assets, which form part of a fixed business base that the transferring party owns in another State, can be taxed in the State where the moveable assets are located.

For this reason, as a company whose assets are mainly movables is not considered to be as real estate assets, its transfers can only be taxed in the country of residence of the transferring party, i.e. the State where the company making the transfer is registered. This principle implies that a transfer made by a German company of participation in a Spanish company would only be taxed in Germany, regardless of the composition of the Spanish company's assets.

As a result of this new agreement, the aforementioned Article 13 has been modified, along with the State where the capital gains can be taxed. The stipulations are as follows:

"The gains obtained by a resident of a State contracting the transfer of shares or participation in a company, (or other similar rights), if at least 50% of whose assets are comprised, either directly or indirectly, of real estate assets located in the other contracting State, can be subject to taxation in this other State".

By virtue of the aforementioned, if the assets of a Spanish company comprised mainly real estate assets, the capital gains obtained in the transfer of its participation by the German parent company, may be subject to taxation in Spain. In Spain the tax rate applicable to the capital gains obtained would be 19%.

In a reciprocal manner, the same rule would apply in cases where the transferring party were an entity registered as resident in Spain and the transferred company was a company resident in Germany.

The new agreement is pending ratification by the respective Parliaments and is expected to come into force in 2012.

If the agreement is ratified in accordance with the terms in which it was drafted, capital gains obtained in Spain through the transfer of shares or participations in Spanish companies comprising at least 50% immoveable assets by German companies will be taxed at 19%. This should be taken into account when analysing, from a financial point of view, the costs and taxes applicable to possible future disinvestments in order to bring the disinvestment forward, as far as possible, to be performed before the new agreement comes into force.

Javier Berreteaga

Reforms introduced by the Law on Sustainable Economy in the real estate sector

As it has been widely debated and reported over the last few months, on the 5th March 2011 the long-awaited Law 2/2011 (dated 4th March) on Sustainable Economy (hereinafter "the Law") was brought through its publication in the Boletín Oficial del Estado (BOE / Official State Bulletin).

Faced with the current financial crisis affecting the Spanish economy, the Government has proposed a series of measures to boost our economy. Among these measures is this Law designed to incorporate structural reforms into the legal system that will help create conditions that favour sustainable economic growth.

As described in Article 2 of the Law, sustainable economy is understood to be a growth pattern that brings together economic, social and environmental development in a productive and competitive economy that favours quality employment, equal opportunities and social cohesion, and that guarantees respect for the environment and the rational use of natural resources in such a way that the needs of current generations are met without compromising those of future generations.

In order to implement the measures required to achieve the aforementioned objective, the Law introduces a diverse and wide-ranging series of reforms to boost the sustainability of our economy. It comprises four titles, twenty additional stipulations, nine transitory provisions, sixty final provisions and a derogation provision.

Regarding the reforms affecting the real estate sector, and referring simply to the main points of the reforms introduced, it should be noted the primary objective of boosting the rationalisation of residential construction in order to attend the needs of the population, renovate and rehabilitate properties and urban areas, protect the environment and make rational use of economic resources stands out.

To achieve this objective, the public authorities will draw up and develop policies for their respective jurisdictions to ensure a sustainable urban environment, creating and updating a general and integrated information system comprising, among other things, a register of empty constructions, buildings, residential and commercial properties (and those requiring improvements or renovation), maps of obsolete urban areas, requirements relating to renovation plans or programmes, and the general and integrated public information system for land and town planning (as stipulated in the Land Law), to enable citizens to access town-planning information electronically.

In this way local governments will be able to promote urban renovation and rehabilitation and will be authorised to order (in accordance with the ways, terms and timeframes established in the applicable legislation) improvement works up to the maximum amount they are legally allowed, in addition to works relating to tourism and culture as included in the applicable legislation, in the event of a construction or a building being affected by a programme, plan or any other legal instrument for the renovation of properties that has been approved and is in force at the time.

Another of the reforms introduced refers to cadastral activities. The modification of the Cadastral Law aims to increase the availability of cadastral information for society as a whole. To achieve this, the time limits for notaries to send cadastral information is reduced, and the cases where these notary publics and the property registrars communicate the information are increased, thereby decreasing the number of situations where property owners are required to provide cadastral information. The amount of cadastral information is also increased regarding both the location and description of the property, electronic accessibility is improved and the property register certification generalised.

Another of the reforms of this Law comprises a modification of the municipality law via the introduction of a new article that stipulates that, as a general rule, local licenses (or other means of control) are not required. However, the Law also stipulates there is an exception to this general rule, as any activity that may affect environmental protection, historical or artistic heritage and/or public health and safety, or that involves the private use and occupation of public assets, may require a license or preventive control, in all cases where the decision of compliance is justified and appropriate.

To achieve this, the Government has been granted authorisation so that, within six months of the municipality law coming into force, it can evaluate the existence of the points included in the new article with regards to the existing provisions on local licenses. In accordance with this evaluation, the Government will present a bill modifying the regulations that do not coincide with the aforementioned points, and eliminating the need for a license, without prejudice to its substitution for other forms of verification and administrative control. The Autonomous Communities and local Entities, will also adapt their regulations to the stipulations of the new article of the municipality law within 12 months of the Law coming into force.

Lastly, it is important to also mention the authorisation granted the Government for the approval of the basic energy efficiency certification procedure for existing buildings within 6 months of the Law coming into force.

These are some of the most significant modifications introduced by the Law that affect the real estate sector. We will have to wait for the results, implications and development of them to be able to properly evaluate their impact on our society.

Alfonso López

Recent case law.

High Court (Civil Division). Sentence no. 827/ 2010 of the 17th December.

This judicial ruling relates to an action brought against the developer of properties that were deemed to have serious structural defects.

The buyers of a residential complex based their action on the breach of contract by the property developer, requesting the developer be obliged to perform the necessary works on the properties to ensure they meet the specifications and characteristics detailed in the project plans.

The judge of First Instance considered that the defects reported by the plaintiffs could not be classed as serious structural defects, due to considering the action relative to decennial liability as stipulated in Article 1591 CC. In the same way, the action brought by the plaintiffs based on the breach of contract was rejected as it was a matter inextricably linked to the former.

In the second instance, the Provincial Court considered the appeal made by the owners. Regarding the action of the aforementioned Article 1591 CC, it concluded that there was ample proof of the existence of serious structural defects. It also concluded that the buyers who bought the properties from the estate agent did so based on the plans with certain specifications that were later modified by the developer without the buyers' knowledge.

The Court concluded that the decision made by the buyers was based on the plans and the project, and not on the technical specifications where the changes were made and which were handed over at

a later date. It argued that projects could be modified as long as the changes are based on technical requirements, or an obligation imposed by the government authorities or current laws, neither of which were circumstances proven by the developer.

Finally, the High Court ruled that the attaching of the Technical Specifications to the purchase contract complies with the legal stipulations of RD 515/1989, of the 21st April, on the protection of consumers with regards to the information to be provided in the purchasing and renting of properties. Therefore, from the moment they are attached to the contract signed by the contracting parties, their content has the same force as the stipulations of the contract. It denied that the properties were bought (as claimed by the plaintiffs) only based on the plans and the project, as the Technical Specifications had been signed by the buyers and attached to the contracts and were, therefore, binding for both parties.

Ignacio Domínguez

High Court (Civil Division, 1st Section). Sentence no. 861/2010 of the 29th December

This sentence deals, in length, with an action brought for the termination of an abusive clause relating to the clause known as the rounding-up clause, more specifically the clause on "rounding up to the nearest quarter of a point", which is inserted into variable interest mortgage contracts between banks and consumers or users.

A lawsuit was brought against a banking entity by the Association of Banking Service Users that made, among others, the following demands:

The first and most relevant of these was the request for the annulment (on considering it an abusive clause) of the general term in variable rate mortgage contracts, specifically the part that read "… rounding up to the nearest quarter of a point", in reference to the interest rate used as a benchmark for the annual revisions of the interest applicable to the mortgage and any other similar ones that refer to rounding up the interest rate that is used as a benchmark for calculating the interest applicable to the variable rate mortgages.

The second demand required the elimination (at the expense of the banking entity) of the aforementioned general term of the contract and any others that had the same purpose of rounding up the interest rate taken as a benchmark for revising the interest applicable to the variable rate mortgages and, at the same time, to abstain from using them in the future.

Naturally, it was also requested the clients of the entity be paid the amounts charged in excess of those that they would have been charged without the application of the aforementioned rounding-up clause, along with the interest legally corresponding to them as per each of the respective dates when they paid higher amounts due to the application of the contested clause.

Regarding these demands, the High Court confirmed each of them and rejected the appeal made by the banking entity, as well as ordering the sentence in question to be entered in the Register of General Terms and Conditions for Contracts.

Lastly, the High Court concluded that all legal and natural persons that had signed a variable rate mortgage contract with the entity being sued, and who had current contracts including the clause that had been annulled, could participate. Therefore, the banking entity was required to notify all the interested parties of the dispositive part of the sentence as well as the enforcing lawsuit, having previously obtained a list of all the clients affected by the sentence.

Ignacio Domínguez

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(**) Squire Sanders Hammonds awarded in 2010 as **REAL ESTATE LAW FIRM OF THE YEAR 2010** in Spain by the following International Publications: (i) Corporate Intl Magazine, (ii) Finance Monthly Magazine, (iii) InterContinental Finance Magazine and (iv) Global Law Experts.