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New Tax Credits in the Real Estate Sector

Royal Decree-Law 18/2012, dated 11 May, concerning the writedown and sale of the financial sector's real estate assets, implements the following new tax regulations:

1. Exemption from 50% of profits obtained on the transfer of real estate assets acquired through 31/12/2012

A 50% exemption has been introduced on the profit from the transfer of urban real estate assets acquired in return for a consideration between 12 May and 31 December 2012.

This exemption will apply to tax payers of Spanish Corporate Income Tax ("CIT"), Personal Income Tax and non-resident income tax.

For this purpose, the real estate assets must not have been acquired from a "related party" (i.e. entities or persons belonging to the same group, their spouse or any individual directly or indirectly related by kinship up to the second degree).

Recall that in the case of companies paying CIT (i) the real estate asset must be recognised on their accountancy as a "non-current" or "non-current held-for-sale asset"; and (ii) the exemption is compatible with the deduction for the reinvestment of capital gains foreseen in article 42 of the CIT Act.

Lastly, recall that payers of personal income tax entitled to apply this exemption and additionally the exemption for reinvestment in habitual residence, must first apply the 50% exemption on the capital gain obtained, so that the other 50% of the capital gain will benefit from the reinvestment exemption which is a proportional exemption based of the percentage of the price reinvested (e.g. if 100% of the price obtained is reinvested, then the capital gain will be totally excluded from taxation).

2. Broadening of the scope of application of the "tax-neutral regime"

Within the framework of measures to clean up the balance sheets of credit institutions, it is established that the special regime for mergers, spin-offs and asset contributions, regulated in Chapter VIII of Title VII of the amended text of the CIT Act (commonly known as the "Tax-Neutral Regime"), shall apply to the transfer of assets and liabilities performed in compliance with this Royal Decree Law 18/2012.

Specifically, this regime shall apply to operations whereby foreclosed assets or assets received in payment of debt must be contributed by credit institutions to a corporation (sociedad anónima).

3. Application of the exemption from article 108 of the securities markets act

The exemption provided in Section 2 of Article 108 of the Securities Markets Act 24/1988, dated 27 July, will not be applicable to the subsequent transfer of shares received as a result of the incorporation of real estate asset management companies foreseen by this Royal Decree Law 18/2012; these transactions will therefore not be subject to Transfer Tax.

The Spanish Government has approved the "fast-track licence" to open retail businesses

The Spanish Government has recently approved Royal Decree-Act 19/2012, dated 25 May, concerning urgent measures to liberalise trade and certain services, Title I of which removes the requirement for a municipal authorisation or licence prior to opening small retail businesses, an initiative which the government does not rule out applying it to larger retail venues or other kinds of activities in the near future.

The removal of the licence requirement is embodied in a total of five articles, regulating the purpose, scope of application, non-requirement of municipal licences prior to opening an establishment, responsible declaration regime and application of the general control regime.

These measures seek to boost and revitalise retail trade activity, by removing the need for municipal licences linked to retail establishments, their facilities and certain preliminary works.

These measures will apply to retail trade activities and the provision of the services set forth in the appendix of the aforementioned Royal-Decree Act, and which, among others, cover the food, clothing and household textile, parapharmacy, building and plumbing materials, car and parts sales, opticians, orthopaedic accessories, musical instruments, antiques, books, stationary, toys, jewellery and plants sectors, as well as small crafts industries.

These activities must be conducted via permanent establishments located anywhere in Spanish territory, whose usable sales and display area does not exceed 300 square metres. Furthermore, activities conducted in the aforementioned establishments and having an impact on historic-artistic heritage or the private usage and occupancy of public goods are excluded.

Specifically, the new regulation establishes that neither the administrations nor public sector entities may require entrepreneurs to obtain a prior licence for facilities, operations or activity, or similar licences subject to prior authorisation for conducting commercial activities or opening the establishment in question.

Neither are changes in ownership of retail activities and services now subject to licence. In these cases a prior communication to the competent body for information purposes will be required.

Moreover, a prior licence or authorisation will not be required to perform work linked to refurbishing establishments in order to carry out retail activity when they do not require a works project in accordance with Law 38/1999, dated 5 November, concerning building planning, except for building works necessary under the applicable planning regulations, which shall continue to be governed, with regard to prior licensing, general requirements and competency for their granting, by the applicable rules.

Article 4 regulates the responsible declaration or prior communication, so that prior licences that may not be required in accordance with the above, shall be replaced by responsible declarations, or by prior communications, in accordance with the provisions of Article 71.bis of Law 30/1992, dated 26 November, concerning the legal framework of the public administrations and common administrative procedures, relating to compliance with the legal provisions established in applicable regulations. In any event, the taxpayer must be in possession of the receipt of payment of the applicable tax when necessary.

However, presentation of the aforementioned responsible declaration, or that of the prior communication, shall in no way prejudge the status and effective suitability of the establishment's conditions to the applicable rules, and nor shall it limit the exercise of administrative powers of verification, inspection, fines, and general monitoring that are attributed to the administration at any level, whether state, regional or local, by the sector regulations applicable in each case.

Finally, for procedures commenced prior to the entry into force of the aforementioned measures, the interested party may drop their application and opt to apply under the new regulations, where applicable.

The planned reform of the Spanish REIT ("SOCIMI")

The Cabinet has recently approved the draft bill concerning measures to flexibilise and promote the housing rental market, introducing changes to the regulation of the Spanish REIT, known as SOCIMI, as well as certain tax credits on non-residents' income.

With regard to SOCIMI, the current requirements would be substantially modified and their legal regime would be rendered more flexible, through implementing the following measures:

- The rental period for assets promoted by the entity would be reduced from 7 to 3 years.
- The requirement whereby the SOCIMI must have at least three assets with none of them representing 40% of its total assets would be lifted.
- The amount of capital required would be reduced from 15 to 5 million euros.
- The limitation whereby external financing cannot exceed 70% of assets would be removed.
- Minimum working capital would be reduced from 25% to 15%.
- The number of shareholders required will be reduced from 100 to 50.
- The percentage of compulsory appropriation of profits would be reduced from 90% to 50%.
- The applicable rate would be maintained at 19%, but would be applied in line with profit (it is currently applied in line with the amount of dividend distributed).
- Lastly, the percentage of exempted income from home rentals would increase from 20% to 25%, provided more than 50% of the asset comprises homes.

Unfortunately, the draft bill does not contain any reference to the Alternative Stock Market (of the Spanish MAB) as a preferred market for SOCIMI. This factor would have to be added during the parliamentary processing of the bill, in order to comply with the objectives and goals pursued by the reform, which are none other than to reactivate and strengthen the real estate market.

With regard to Non-Residents' Income Tax ("IRNR"), the draft bill provides that the treatment of persons who are not resident in Spain (subject to IRNR) should be brought into line with that of residents (subject to Personal Income Tax, "IRPF"), in respect of the returns obtained on housing rentals. Consequently, non-residents would be able to apply the 60% reduction on returns obtained from this kind of rental, a reduction which would be ramped up to 100% when (i) the lessor is an EU resident, unless he resides in a tax haven, and (ii) the lessee is aged between 18 and 30 years and receives working income above the Multipurpose Public Income Indicator (of the Spanish "IPREM").

The capital clean-up in the financial sector and the disposal of its real estate assets

The Spanish Government recently approved Royal Decree-Act 18/2012, dated 11 May, on the restructuring and sale of real estate assets in the financial sector, in order to boost the credibility of Spain's banking system in the current economic environment, and in turn to help enhance financial stability not only in this sector but throughout the Spanish economy.

In summary, Royal Decree-Act 18/2012 establishes additional provisioning requirements on top of those provided in Royal Decree-Act 2/2012, dated 3 February, due to the impairment losses on loans linked to real estate activity classed as normal. Like their predecessors, these new requirements are established in a single raft of measures, differentiated by the various types of financing involved, in order to factor in the market's lower expectations with respect to the amounts recorded in the entities' financial statements, evidenced through market capitalisations that are significantly lower than the assets' underlying book value.

With regard to the schedule for compliance with these new requirements, as a general rule the entities must meet them by 31 December 2012. However, those entities which, during 2012, are involved in new mergers, will be given twelve months from the date of obtaining merger authorisation to account for the losses.

For this purpose, credit institutions must have submitted a plan to the Bank of Spain by 11 June 1012 at the latest, detailing the measures they plan to take to implement the new requirements.

When, in order to comply with the new real estate risk provisioning requirements, credit institutions' capital is deteriorated to the point where their core capital or equity are in shortfall, a series of alternative measures must be envisaged which, in some cases (if deemed appropriate by the Bank of Spain) could mean they are required to ask for public financial aid via the Bank restructuring Fund (FROB - Fondo de Reestructuración Ordenada Bancaria). In these cases the latter would acquire ordinary stock or other instruments convertible in capital.

Moreover, capital entities must be set up into which credit institutions must contribute all foreclosed real estate assets or property received in payment of debts linked to land for property development and with real estate building projects or developments. Accordingly, it is vital to ensure that the valuation of these assets is in line with the market reality and that the aforementioned entities are professionally managed.

Lastly, the notary and registrar fees applicable to financial or real estate asset transfers as a result of the clean-up and restructuring of financial entities have been lowered.

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Furthermore, the necessary rules are implemented to ensure the fiscal neutrality of the operations to incorporate the asset management entities. In order to stimulate the sale of real estate assets, with regard to corporate income tax, personal income tax and tax on the income of non-residents, a partial exemption has been introduced for income deriving from the transfer of urban real estate acquired since the new regulation came into force, i.e. from 11 May, and until 31 December 2012, provided certain requirements are met.

Lastly, the notary and registrar fees applicable to financial or real estate asset transfers as a result of the clean-up and restructuring of financial entities have been lowered.

Brief notes on the draft Act to reform the Urban Leases Act

On 11 May, the Spanish Government presented the draft Act concerning measures to flexibilise and promote the housing rental market, whose purpose is to render the rental market more flexible by reducing the duration of contracts, improving the legal security of rental contracts, speeding up the foreclosure procedure and introducing certain fiscal stimulus measures.

Below we outline a few brief notes on this new draft bill, which, although aimed specifically at home rentals and not rentals for other purposes, we think will boost the real estate market.

In the first place, while the current Urban Leases Act (of the Spanish LAU) stipulates that rental rates must be updated in line with CPI and that lessees' first-refusal acquisition rights are irrevocable in contracts lasting less than five years, the draft Act recognises the willingness of parties to agree the future updating of rental rates, and provides for the possibility of lessees' relinquishing first-refusal acquisition rights. However, the draft Act establishes that, unless otherwise agreed, said first-refusal acquisition rights shall be maintained.

With regard to the duration of rental contracts, the draft Act reduces the mandatory contract period from five years (as stipulated in the Urban Leases Act) to three years. Furthermore, the tacit extension period of rental contracts is reduced from three years to one year.

The draft Act recognises the lessor's right to terminate the contract regardless of its duration, provided he gives at least one month's notice, in contrast to the provisions of the Urban Leases Act, which only recognises this right in contracts whose agreed duration exceeds five years, with two months' notice.

Among the lessor's rights is the entitlement to recover the property as either his own or a first-degree relative's habitual residence, even when said right is not written into the rental contract, with no other requirement than two months' notice.

In the event of transferring ownership of a home, the draft Act recognises the acquirer's obligation to maintain the lessee only in those cases in which the rental contract is registered in the Property Registry. Surprisingly, said registration is not mandatory, but is up to the parties.

In the case of termination of the contract due to failure to pay the rent, legal timelines and proceedings have been speeded up, with the lessee being given ten days to pay the outstanding sum, and with no need to begin legal proceedings and obtain a declarative ruling in order for non-payment of the rent to trigger termination of the contract.

For further information

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