SQUIRE SANDERS

CORPORATE - REAL ESTATE TAX ALERT

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New tax measures for the leasing market

At the end of last August the Board of Ministers passed the Bill for the Act on Measures for the Flexibilization and Promotion of the Rental Housing Market which, among other measures, includes the following of a tax nature:

1. REIT. Real Estate Investment Trusts (of the Spanish, SOCIMI)

The Bill flexibilizes some of the requirements for application of the special regime for its simplification.

- The period for maintaining the property in lease for promotion by the trust will be reduced to 3 years.
- The requirements for diversification will be eliminated (currently a minimum of 3 properties without any one representing more than 40% of the assets).
- The minimum share capital will be decreased to 5 million euros.
- The tax rate would be 0% for income from the development of its corporate and specific purpose, and the shareholders would be taxed at 19%.
- The obligation to distribute profits from its activity would be decreased to 80% (90% at present).
- It would allow the listing on a multilateral trading system (for example, the Alternative Stock Market).
- The restriction on outside financing would be eliminated (current limit: 70% of the assets).

2. Special regime for entities devoted to the rental of dwellings

The main measures to be implemented would be the following:

- The minimum number of dwellings rented or offered would be 8 (currently: 10).
- The requirement for the maximum surface area of the dwelling (135 m2) would be eliminated.
- The dwellings should remain rented or offered for at least 3 years (currently 7 years).
- The special tax regime would be applicable to those entities with activities that are complementary to the main rental activity, if at least 55% of the rents could generate income with the right to a rebate.

3. Non-resident Income Tax. Special tax on real estate of non-resident entities

The Bill would limit the submission to such tax exclusively to those entities residing in a country or territory deemed as a tax haven.

The Bill is still being processed in Parliament whereby the measures that may ultimately be approved could differ from those listed, making the final version the subject of a new publication by us.

The asset management company or "bad bank"

On 31 August 2012 Royal Decree-Act 24/2012 on the restructuring and resolution of credit institutions was passed in which, following months of conjecture, first on whether the so-called "bad bank" would be created in Spain and, second, the terms of its creation, the existing doubts have only been partially clarified.

On the one side, with respect to the first of the uncertainties, we will ultimately have a "bad bank" in the form of a corporation that will be created under the name of Sociedad de Gestión de Activos (SGA or Asset Management Company,).

With respect to the second and perhaps most relevant question, a major part of the terms regarding the operation of this company will be developed in the future. To this regard, it is envisaged that the FROB may obligate a credit institution (obviously an institution subject to a restructuring process, in other words, one that has sought public financial support in

the search for viability) to transfer given asset categories to the SGA that are particularly damaged or whose permanence on the balance sheet of the entity is considered detrimental to its feasibility, in order to remove such assets from the balance sheet and allow the independent management of their sale. Neither does this provide much clarity, since actually it is nothing more than the definition of "bad bank". The most significant part of the regulatory development is pending; which is none other than determining the categories of assets to be transferred, the manner in which this is to be conducted and the price at which such transfer will take place.

At present only some general principles have been established for the process for contribution to the SGA, which are as follows:

a) The transfer will take place without the need for third-party consent by means of any legal transaction and without the need to comply with the procedural requirements necessary for structural modifications of commercial companies;

b) Prior to the transfer, the credit entity should adjust the appraisal of the assets according to criteria to be determined by regulation;

c) Likewise prior to the transfer an appraisal will be performed by one or several independent experts of the assets to be transferred, that should follow commonly-accepted and adequate methodologies in order to provide a realistic estimate of the assets (in principle this is what would be expected of an independent report but there is no harm in making specific reference to realism in the appraisal);

d) This independent expert appraisal will replace any that, where appropriate, could be required in accordance with the Capital Companies Act on the basis of how the transfer is implemented;

e) In no case may the transfer to the FROB be terminated by virtue of actions for reinstatement under the Bankruptcy Act;

f) In the event of the transfer of credits deemed to be under litigation, the provisions of Article 1535 of the Spanish Civil Code will not be applied (in other words, the debtor will not have the right to extinguish it by reimbursing the FROB for the price paid, legal costs incurred and interest on the price as of the day on which it was paid);

g) The acquiring company will not be obligated to launch a takeover bid in accordance with securities market legislation;

h) The transfer of assets will not constitute a case of succession or extension of tax or social security liability;

i) The SGA will not be liable for any tax obligations accrued prior to the transfer deriving from the ownership, operation or management of the assets.

In conclusion, while it is a first step toward the creation of a bad bank, there are several uncertainties yet to be clarified; in particular, one whose clarification will take some time and which is whether this entire process will ultimately be done at the expense of the taxpayer. It will solely be possible to calculate this once the transfer price of the assets to the SGA is known and therefore, the losses are to be assumed by the credit entities (their shareholders) or the State (the taxpayers).

The flexibilization of the rental housing market – legal aspects

On 24 August 212 the Council of Ministers passed the Bill for the Act on Measures for the Flexibilization and Promotion of the Rental Housing Market, in an endeavor to make the Spanish rental market more competitive.

In accordance with data published by the National Institute of Statistics, the Spanish rental housing market is composed of approximately 1.8 million dwellings, occupied by 17% of the Spanish population as opposed to the 83% who live in homes of their own. The aforementioned disproportion is evidence of the fact that, to date and in spite of the existence of a base of 3 million uninhabited dwellings that could be rented, the rental market does not pose an alternative to home ownership, which is why the aforementioned Bill seeks to streamline the rental housing market in our country as well as reinforce the legal certainty of such sector, improving the regulation of the eviction process in particular.

The main measures adopted for such purpose by the aforementioned Bill, and which entail the introduction of amendments to Urban Leasing Act 29/1994, 2 November, are briefly summarized below:

- As in the case of non-dwelling leases, priority is given to the will of the parties, so that they may resolve:
  - To apply any improvements or reforms, agreed to be conducted by the lessee, to the payment of the rent.
  - The review of the rent (currently this is done in accordance with the Consumer Price Index).
  - The waiver by the lessee to first refusal rights in contracts with a term of less than five years.
- The term of the rental contract will be as expressly stipulated between the parties, without prejudice to the establishment of the following reductions:
  - The term of compulsory contract renewal is reduced from the current 5-year period to 3 years and, consequently, the updating of any deposits is adapted to this new 3-year period.
  - The period of tacit contract extension is decreased from the current 3 years to 1 year.

- The power of the lessee to withdraw from the rental contract is more flexible, and may be done at any time providing that the lessor is notified at least one month in advance. Without prejudice to the foregoing, the parties may stipulate that, in the event of the aforementioned withdrawal, the lessee should compensate the lessor with one month of the rent in force for each year remaining on the contract in force.
- The power of the owner is recognized to recover the dwelling as his customary residence without the need to expressly envisage this option in the contract, while always providing that, (i) such dwelling is to be used as the customary place of residence for the owner, first-degree relatives or spouse in the event of separation, divorce or annulment and (ii) it is notified to the lessee at least 2 months in advance.

Likewise and together with the aforementioned measures to flexibilize the rental market, the Bill establishes that the buyer of a dwelling with a rental contract would not be obliged to maintain the tenant whose rental contract is not registered.

Lastly, with regard to improving the regulation of the eviction process, the Bill for the Act on Measures for the Flexibilization and Promotion of the Rental Housing market amends Spanish Civil Procedure Code 1/2000, 7 January, so as to expedite and reduce the periods and legal proceedings as follows:

- When action is brought for eviction, the lessee will be given a period of 10 days in which to settle his debt or set forth the reasons justifying nonpayment.
- If the lessee fails to appear, pay or duly justify the nonpayment, the Judge will deem the proceeding as terminated and proceed with the eviction.
- The proceeding will be terminated by Court Order (as opposed to a decree from the Court Clerk).

Jurisprudence and resolutions of the D.G.R.N.

The Supreme Court declares that the right of the lessor to raise the rent of a business premise following the merger of the lessee is appropriate as of the registration in the Mercantile Registry of the merger and not as of the notice from the lessor to the lessee of such increase in rent.

Supreme Court Judgment number 514/2012 (Civil Chamber, Section 1)

This Judgment of the Civil Chamber of the Supreme Court, Section 1, 20 July 2012 analyzes, among other issues, whether following a merger of the lessee, the moment at which the right to increase the rent on such grounds is that of its registration in the Mercantile Registry or as of the moment at which the lessor notifies the lessee of the increase in rent.

With regard to the issue at hand, the Provincial Court adjudged in second instance that the update of rent should take place following the notice from the lessor to the lessee on the increase thereof, and not as of the registration of the merger in the Mercantile Registry, even if this takes place first. Such Court followed the criterion on the non-retroactivity of rent updates in dwelling rentals set forth in Article 18.3 of Urban Leasing Act 29/1994, 24 November (hereinafter, the "LAU") which establishes that the updated rent will be required of the lessee as of the month following the one in which the interested party provides written notice of this to the other party, expressing the percentage of change applied and attaching, if the lessee so requires, the appropriate certificate from the National Institute of Statistics or reference to the «Official Gazette» in which it was published.

In view of this resolution, the plaintiff filed an appeal for cassation before the Supreme Court in that it considered that the procedural requirements for application of the rent increases of Article 18.3 LAU by analogy or interpretation of the rule for non-retroactivity to the case of business premise rentals were lacking.

The Supreme Court upheld the appeal for cassation of the plaintiff with the understanding that Article 18.3 LAU cannot be applied by analogy, since the parties did not submit to Title II LAU, where such Article is located, as inferred from Clause Three of the contract "applicable legislation".

The Supreme Court likewise considers that since this is a rental contract for a business premise and not a dwelling, this is not a case of rent review but rather a case of the right of the lessor to collect, by legal provision, a raise or increase in the rent stipulated as a result of the mergers performed.

The Court clarifies that the effects of the merger on the rental relationship occur as of the moment at which these take place, irrespective of whether or not it is known by the lessor company. To this regard it understands that the alleged knowledge of the mergers by the Mercantile Registry is not the equivalent of the obligation of the lessee by virtue of the contract to obtain the express and prior, written authorization from the lessor for the assignment, or of the obligation stipulated in Article 32.4 LAU that requires that the lessor be given certified notice of the assignment as well as of the sublease within one month of their arrangement.

Additionally, the Supreme Court states that the increase in rent is not subject to the decision of either party but instead entails a right established in favor of the lessor ("will have the right" as per Article 32 LAU).

Lastly the Supreme Court concludes that the lessee was aware, as inferred from the contract as well as from the law to whose application the parties submit suppletorily, of the right of the lessor to increase the rent and do so as of the occurrence of the events that determined the increase, whereby as of that moment it should have made the appropriate financial provisions in order to be able to adapt itself to this new situation, without the action of the lessor in any way entailing the retroactive application of the rule and, conversely, a benefit for the lessee that did not provide notice of the mergers and failed in due time to withstand the increase that the lessor could have legally applied to it.

The establishment of a surface right for the installation of solar panels on the roof of a building does not require the prior segregation or individual specification of the property to which it corresponds, providing that the property seeking access to the land registry is sufficiently defined.

Directorate General of Registries and Notary Publics (Land). Resolution number 3593, 15 February 2012

In this case, the Property Registrar suspends registration because, in his opinion, the surface rate established in the deed does not comply with the requirements for the principle of specification, since by not being established over the entire property the prior individual specification of that part of the property to which it corresponds is necessary, by any of the means envisaged in mortgage legislation such as segregation, material division, constitution in a horizontal property regime, etc.

The Directorate General establishes that, while various theories exist on the nature of the surface right, the truth is that broad consensus exists that the surface right holder is the entitled owner of what is built or the construction on the land of another, albeit temporarily, and of the right to have or maintain the construction. In this sense, the land ownership – projection ownership dualism is going to define a special legal regime when this affects a portion of property that clearly differentiates it from the rest and which requires specific publicity by registration.

Pursuant to this, according to the Directorate General, there is no reason whatsoever to prevent the opening of a separate page on the portion affected by this right, in that there are sufficient legal and economic reasons for this; without the need to previously individualize that part of the property on which the surface right is established, providing that the essential rules that govern the real estate registry regime are fulfilled.

Therefore, for the registration of the surface right established in this case, the segregation or individual specification to which the Registrar refers in his rating is not necessary, since it complies with the requirements deriving from the principle of specification and from the specific legal regulation on this matter, in that the property seeking registration in the Land Registry is sufficiently defined.

Consequently, the Directorate General resolved to uphold the appeal filed and to revoke the challenged rating.

In the event of the nonpayment of rent, notice from the lessor to the lessee must solely be certified, and it is not necessary to advise him of the consequences of nonpayment in the interests of a possible enervation of the action for eviction that could be filed as a result of the aforementioned nonpayment.

Provincial Court of Las Palmas, Section 5, Judgment dated 30 March 2012, appeal 564/2011

In this appeal, the Court analyzes the enervative power of the eviction that assists the lessee according to the current Civil Procedure Code and by means of which eviction processes for nonpayment of rents or quantities owed by the lessee will end if prior to the hearing "the lessee pays the plaintiff or places at his disposal in the court or via notary, the amount of any quantities claimed in the complaint (…)", although the foregoing will not be applicable when the lessor "shall have requested payment from the lessee, by any certified means, at least 4 months prior to the filing of the complaint and payment has not been made prior to such filing".

The main legal issue focuses on determining whether the request for payment made to the lessee by the lessor should include a mention of the consequences of nonpayment. In this sense, several Provincial Courts have opted to follow the mainstream doctrine that requires an inclusion in the notice for payment of a true declaration of the will of the lessor to terminate the rental contract if the quantities set forth in such notice are not paid.

In the case at hand, the court of appeal has aligned itself with another trend, according to which "it is solely necessary to have provided the lessee with a certified request for payment", without the need to warn him of the consequences of the nonpayment or warn him that if he does not pay he will be unable to enervate any action for eviction that could be filed as a result of the aforementioned nonpayment.

Consequently, the Provincial Court upheld the appeal filed by the lessor party, revoking the judgment of first instance, declaring the grounds for the eviction of the lessee and convicting him to the payment of the quantities claimed plus the corresponding legal interest, as well as to the payment of the costs borne by first instance.

For Further Information

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