SQUIRE SANDERS

Spanish Real Estate Legal Update

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In this issue:

Amendments to the regulation applicable to SOCIMIs

On last December 28, the Official Gazette of the Spanish State published Act 16/2012, December 27, adopting several tax measures aimed at the consolidation of public finances and the promotion of economic activity, as a continuation of the package of measures recently adopted, in order to consolidate public finances and correct the main imbalances of the Spanish economy for a greatly-awaited emergence from the crisis.

Among the measures approved, we highlight the amendment of given aspects of the regulation applicable to Listed Real Estate Investment Companies (so called SOCIMI). Such entities were created in the year 2009 by means of Act 11/2009, October 26, in order to create a new instrument for investment aimed at the urban leasing real estate market.

Due to the scarce reception of such entities on the market, a revision of their legal framework was undertaken to encourage their promotion in the Spanish market, as occurs in other countries of our environment, in an endeavor to maximize and stimulate a Spanish real estate market that has been seriously affected by the crisis.

While the main novelty lies in the tax treatment of SOCIMIs, as we indicate more extensively in another of the articles of this issue of our newsletter, a series of amendments to the substantive scope of these entities is also worthy of mention.

Perhaps the most significant novelty lies in the ability of the SOCIMI to be listed on a multilateral trading system, and the possibility of their quotation on the Alternative Stock Exchange (so called MAB). It is obvious that the requirements and procedures for listing on the MAB will entail an important advantage, since these are more flexible and less costly that those envisaged for trading on the Spanish stock exchange.

Likewise, together with the reduced minimum share capital requirement of five million euros, the prior restriction on outside financing is eliminated and the assets of SOCIMIs may now be composed of one sole property. Greater flexibility is thus given to some of the requirements imposed by prior Act 11/2009 under amendment and which, to our understanding, had not done much to facilitate the incorporation of these entities.

Without embarking upon further amendments, which will be announced in another of our articles, we merely wish to mention that the amendments of Act 11/2009 will take effect for the tax periods commencing as of January 1, 2013.

We should therefore await the upcoming months in order to verify the results of the amendments

implemented and see whether these allow the SOCIMI to have the same reception that the REIT (Real Estate Investment Trust) has had in other countries for some time, and which has served as an inspirational figure for the SOCIMI; although everything appears to indicate that this time the proposed objective will be achieved.

Alfonso López

Main fiscal novelties applicable to the real estate sector

The following are some brief references to the main fiscal novelties recently approved and which are applicable to the real estate sector.

Act 16/2012, December 27, on economic measures

Personal Income Tax: As a general rule, the **deduction for usual residence** is eliminated for dwellings acquired as of January 1, 2013.

Transitional system: It will nevertheless be possible to continue benefitting from such condition, pursuant to the conditions in force at December 31, 2012, for those taxpayers who, prior to January 1, 2013 acquired their usual residence or paid quantities for the construction, reform or extension thereof, and claimed the aforementioned deduction for such dwelling prior to the year 2013, unless they shall have benefited from the deduction for prior dwellings or from the exemption for reinvestment.

Those taxpayers who claimed deductions for contributions toward a home savings account, that has not been open for 4 years by December 31, 2012, may return any deductions claimed for this concept in the tax return corresponding to the year 2012, without default interest.

The assessment of **payment in kind for the use of a dwelling** by workers will be as follows: (i) If the dwelling is the property of the employer, this will be 10% of the cadastral value (5% for properties whose cadastral value was revised as of January 1, 1994), providing it does not exceed 10% of all other considerations from employment; (ii) If the dwelling is not the property of the employer, this will be the cost for the employer, and may not be less than the appraisal corresponding to the preceding case.

Transitional system: During the year 2013, the worker may continue appraising the dwelling as if it were the property of the employer, providing that: (a) The worker had been using the dwelling prior to the entry into force of this Act; and (b) The employer had been making such payment in kind prior to October 4, 2012.

Corporate Income Tax: For the years 2013 and 2014, **depreciations are limited** to 70% of the quantity that would have been tax deductible in the absence of this measure:

Assets to which this measure is applied: (i) Fixed assets, intangible assets and real estate investments, and (ii) Assets subject to the special leasing system.The following are excluded from this measure: (i) Small-sized Enterprises, except those elements that are depreciated in accordance with the special depreciation system for new fixed asset and intangible asset elements, for equity item elements for reinvestment, and for those assets that are depreciated in accordance with the special leasing system, and (ii) those assets that shall have been covered by a specific communication or authorization procedure by the Tax Authorities, with regard to their depreciation.

Any quantities whose depreciation is not tax deductible in accordance with the preceding section will be tax deductible as of the first tax period that commences in the year 2015, as follows: (i) Linearly for a period of 10 years; or (ii) Throughout the useful life of the equity item.

Effective as of January 1, 2013, the requirements for access to the **system of entities devoted to the leasing of houses** will become more flexible as follows: (i) The minimum number of dwellings leased or offered in lease is 8 (previously 10); (ii) The minimum period for the lease of each dwelling is 3 years (previously 7); (iii) The constructed surface area requirement for dwellings is eliminated.

Tax system of certain leasing agreements: with

respect to the application of accelerated depreciation, and effective as of January 1, 2013, the placement into operating conditions of the asset will be deemed as having taken place at the start of its construction. Requirements:

- Prior notice should be given to the Tax Authorities.
- Lease payments should be made significantly prior to the end of asset construction.
- The period for asset construction should be at least 12 months.
- Assets should be unique in terms of their design and technical requirements, and should not correspond to mass production.

Transitional system: Equity items with respect to which the corresponding administrative authorization has been obtained relative to the moment of the placement into operating condition in a tax period commencing prior to January 1, 2013 will be governed by the provisions of legislation in force at December 31, 2012.

The possibility is introduced of applying **adjusted book values** with respect to assets appearing in the first balance sheet closed subsequently to December 28, 2012, providing that their depreciation has not been deducted in its entirety. The following may apply this measure: (i) Corporate Income taxpayers; (ii) Personal Income taxpayers who pursue economic activities and pay taxes via the direct estimate method; (iii) Non-Resident Personal Income taxpayers with a permanent establishment.

Adjustment coefficients are determined by Law. Adjustable elements are as follows: (i) Fixed assets; (ii) Real estate investments; (iii) Fixed asset and real estate investment elements acquired by leasing. The effects of the adjustment, of a resolutive nature, are conditioned upon the exercise of the purchase option; (iv) Equity items corresponding to concession agreements registered as intangible assets by concession companies that apply the accounting criteria relative to public infrastructure concession companies.

The exercise of this option applies to the entirety of adjustable elements, barring real estate, which may be performed individually. The option should be applied between the closing date of the balance sheet and the date of its approval. The tax will be 5% of the total capital gain.

The system applicable to the SOCIMIs becomes more flexible, effective January 1, 2013:

The possibility is introduced of listing SOCIMIs (Listed Real Estate Investment Companies) on a multilateral trading system, such as the Alternative Stock Exchange (of the Spanish, MAB). To date it was only possible to list them on regulated markets. The minimum capital is 5 million euros (previously 15 million) and their shares should be registered. Limitations to outside financing are eliminated (previously this could not exceed 70% of company assets). No minimum number of properties is required in their assets (this was previously set at 3 and none of them could represent more than 40% of company assets). The real estate acquired or promoted by the SOCIMI should remain leased for at least 3 years (previously the period was 7 years for properties promoted by the SOCIMI).

The following obligation is established for the distribution of profits to shareholders:

100% of the profits from dividends deriving from stakes in:

- Other SOCIMI or similar, non-resident entities.
- Entities whose main corporate purpose is the acquisition of urban real estate for lease and that are subject to the same system established for SOCIMIs in terms of the distribution of profits and investment.
- Collective Real Estate Investment Institutions.

At least 50% of the profits from the transfer of real estate and stakes described in the preceding section.

At least 80% (previously 90%) of all other profits (lease proceeds).

Main characteristics of the tax system for SOCIMIs: 0% levy on Corporate Income Tax. Special 19% levy on dividends distributed to shareholders whose stake percentage in the SOCIMI is equal to or greater than 5% and such dividends are exempt or taxed at a rate lower than 10% at their place of residence.

Withholdings to shareholders: the general system will be applied and, where appropriate, the provisions of international conventions for the avoidance of double taxation.

With regard to their shareholders: (i) IS (Corporate Income) or IRNR (Non-Resident Personal Income) Taxpayers with a permanent establishment will be taxed normally, without the possibility of applying the deduction for avoiding double taxation. (ii) IRPF (Individual Income) or IRNR (Non-Resident Personal Income) Taxpayers without a permanent establishment will be taxed normally, without the possibility of applying the 1,500 Euros exemption in the case of dividends collected by individuals, or the exemption for the sale of listed securities in Non-Resident Income Tax legislation.

Non-Resident Income Tax: As of January 1, 2013, only those entities with residence in tax havens will be subject to the Special Real Estate Tax of Non-Resident Entities.

Transfer Tax and Stamp Duty: The non-subjection to Stamp Duty of the Transfer Tax and Stamp Duty is introduced for **provisional writs of attachment ordered at the motion of the competent Administration,** which were previously subject to but exempt from such tax.

Local Taxes: Within the scope of the Real Estate Tax, and effective January 1, 2013, the exemption is eliminated for those **properties that form part of Historical Heritage** and that are subject to economic activities, unless any of the exemptions are applicable to them as envisaged in Act 49/2002, December 23, on the tax system for not-for-profit institutions and tax incentives for patronage. With respect to such properties, City Councils may regulate a tax rebate of up to 95%.

As of January 1, 2013, the optional rebate (up to 95%) of the Tax on Building, Installations and other Works is extended to the Real Estate Tax and the Tax on Commercial and Professional Activities when these undertake **economic activities declared to be of special municipal interest or utility** on the grounds of social, culture or employment development circumstances that justify such declaration.

Act 17/2012, December 27, on the General State Budget for the year 2013

Value Added Tax: Within the scope of the Value Added Tax and effective as of January 1, 2013, second or subsequent deliveries of building in exercise of a purchase option during the year with respect to leasing agreements with a term of less than 10 years will be exempt.

In relation to the new case of taxpayer investment in work execution, established by Anti-Fraud Act 7/2012, October 29

The Binding Response to Consultation number V2583-12, December 27, from the Directorate General of Taxation clarifies certain situations in relation to taxpayer inversion in work execution, establishing that: (i) the recipient should act as employer or professional. Public entities, individuals, associations, cooperatives and other not-for-profit entities should provide the prime contractor with express and certified notice that they are acquiring the good or service in their capacity as employer or professional; (ii) the operation should be performed within the scope of a process for the development of land, construction or building restoration. This means that the works for preservation and maintenance of the buildings and all ancillary works deriving therefrom will not give rise to taxpayer inversion; (iii) the operations should be the result of contracts formalized directly between the developer and prime contractors. Therefore, ancillary works such as the repair of dampness, tiling and similar tasks performed following delivery of the final works, but during the warranty period, will cause taxpayer inversion, providing that such works derive from the main contract for urban development, construction or restoration; (iv) taxpayer inversion will likewise be applied in mixed contracts (for example, those in which the design and execution of work is commissioned for a fixed price) included under processes for the urban development of land, construction or restoration of buildings,

irrespective of the relative weight granted in the contract to the service rendered and to the execution of the work.

In personnel assignment operations it is necessary to assign personal exclusively to the execution of the real estate work that fulfills all of the aforementioned requirements.

The taxpayer investment rule will apply to works certificates by which payments are made as of October 31, 2012.

The new Invoicing Regulation approved by Royal Decree 1619/2012, November 30, establishes that in cases of taxpayer investment, the invoice will make indicate "Inversión del sujeto pasivo".

Alejandro Zubimendi

One more step toward the elimination of administrative hurdles for the exercise of retail trade

One of the objectives of Act 12/2012, December 26, on urgent measures for the liberalization of trade and given services, which took effect on December 28, 2012 (hereinafter, "the Act"), has been the promotion of retail trade by means of the elimination of certain administrative constraints that paralyze the start and development of some trade activities, with the ability to achieve the objective sought by means of other control procedures.

In doing so, this Act has gone one step beyond what was regulated in Sustainable Economy Act 2/2011, March 4, by virtue of which and in general, the requirement for permits and other preventive control measures for the exercise of some activities has been eliminated, unless such permits are required for the protection of public health or safety, the environment, artistic-historical heritage, or when these require the private use and occupation of public property but, in all cases, conditioning their requirement on a diagnosis of need and proportionality.

Following the new Act, all prior municipal authorizations or permits have been eliminated for protection of the environment, public safety or health, the exercise of retail trade activities and given services envisaged in the Act, performed in permanent establishments located anywhere in Spain and whose useful floor space for exhibit and sale to the public does not exceed 300 square meters.

Such permits have been replaced by statements of compliance or prior notices, with the mandatory requirement in all cases to be in possession of the receipt for payment of the corresponding tax, when necessary. Such documents should contain an explicit statement of compliance with any requirements necessary in accordance with legislation in force.

Therefore, to commence certain trade activities and given services, government administrations or entities may not require the attainment of a prior installation, operating or activity permit, or any other similar or analogous ones that subject the trade activity to be undertaken to prior authorization, or to the possibility itself of opening the corresponding establishment.

Likewise, in relation to fitting-out works for premises to be devoted to the development of the trade activity, no prior permit or authorization will be required when such works do not require the drafting of a construction project in accordance with Article 2.2 of Building Act 38/1999, November 5.

Administrative control will take place a posteriori, and the penalty scheme in force on matters of domestic trade, land management and urban planning, protection of health, the environment and artistic-historical heritage will be applied.

Sandra Paoletti

Amendment of Article 108 of the Securities Market Act

Final Provision 1 of Act 7/2012, on the amendment of tax and budget legislation and for the adaptation of financial legislation to intensify actions for the prevention and fight against fraud,

amends Article 108 of Act 24/1988, July 28, on the Securities Market Act (of the Spanish, LMV).

In accordance with the statement of reasons of the aforementioned Act 7/2012, the purpose of such amendment is to adjust the controversial Article 108 LMV, as it was originally established, in other words, "as an anti-tax evasion measure in possible security transfers that merely serve to cover property transfers by means of the interposition of shell companies".

In doing so its regulation has been simplified and the precept has been reformed, so that such amendment entails three substantial changes:

- Taxation is established, if the anti-evasion regulation is applied, by means of the tax that would have corresponded (Property Tax (of the Spanish, ITP) or Value Added Tax (VAT)), and not necessarily in the form of Property Transfers under the Transfer Tax and Stamp Duty, as the case had been to date.
- Purchases on the primary market are excluded from possible taxation.
- And perhaps the most significant one: "the wording of the Article is simplified, from an objective provision to becoming an authentic provision for fighting fraud, although in the clearest cases an iuris tantum presumption is established that, where appropriate, should be refuted by the interested party if he opposes the application of the anti-evasion measure."

It has been possible to determine such amendment, to a large extent, by the dubious adequacy to date of the aforementioned Article to Spanish and EU legislation, revealed by means of an EU Opinion and two preliminary rulings set forth by our Supreme Court.

In view of the above, in addition to reducing the extension of the wording of the Article, not just eliminating some situations (in the case of transfers on the primary market), but also simplifying the rules for application of the provision by means of the establishment of more clear and concise criteria allowing for a more simplified interpretation thereof.

Likewise the application of the tax corresponding to the specific situation has been established, and not necessarily the ITP, as before. And furthermore, solely and exclusively in those cases in which the transfer of securities is endeavored avoid the payment of taxes corresponding to the transfer of property, likewise establishing a series of presumptions for the most characteristic cases of tax evasion, which the taxpayer will in all cases be able to refute.

Ignacio Domínguez

Recent case law

Moderation by the Supreme Court of compensation in favor of the lessor of a business premise whose lessee unilaterally and unjustifiably terminated the contract prior to the stipulated term.

Supreme Court, First Civil Chamber, Ruling dated April 9, 2012, appeal 229/2007

In this appeal, the court analyzes the extent of the consequential damages and future loss of profits that correspond to the lessor of a business premise on the occasion of the unilateral termination by the lessee, caused by the failure to obtain the mandatory licenses for the supermarket business of such premise.

The first instance ruling partially allowed the claim filed by the lessor, based on the fact that the failure to obtain the necessary licenses within the period indicated in the lease agreement was not attributable to such lessor. It likewise considered that the quantity to be paid by the defendant should be the quantity equivalent to the period of time that the lessee had to obtain the business licenses, in other words eight months, during which a grace period had been stipulated for payment of the rent.

The second instance ruling allowed the remedy of appeal filed by the plaintiff and revoked the first instance ruling, concluding that the quantity that the lessee should pay for the unilateral termination of the lease agreement should correspond to the rent for the full term of such

agreement, in other words six years, while deducting the eight-month grace period.

In summary, the High Court allowed the appeal for cassation filed by the lessee based on the fact that loss of profit requires proof, as in the case of any damage or harm. And likewise determining that the setting of this type of compensation should be addressed by the courts using criteria seeking a balance that eludes both the rejection of lack of profit on the grounds of its hypothetical nature, as well as its unconditional allowance without any evidence whatsoever, since the quantity thereof should be set in accordance with the evidence by means of a reasonable calculation and in keeping with all concurring circumstances and foreseeable expectations of the market.

Consequences of the consideration of a bank transaction as a debt offset or pledge enforcement following the declaration of insolvency.

Ignacio Domínguez

Supreme Court, First Civil Chamber. Ruling dated June 20, 2012.

The insolvency administrators (hereinafter, "the Plaintiff") of the company Santa Teresa Materiales de Construcción S.L. (hereinafter "the Company") sought the declaration of invalidity of the transaction undertaken by the Banco Santander S.A. (hereinafter, "the Bank") classified by the Plaintiff as debt offset.

The events occurred as follows: on January 25, 2007, the Bank and the Company executed a credit policy in an amount of one hundred thousand euros (€100,000) maturing on January 25, 2008. On April 26, 2007, such policy was increased by three hundred thousand euros (€300,000). Likewise on that day, the Bank and the Company arranged a policy for the pledge of two thousand nine hundred forty-eight (2,948) equity shares of the Company in mutual funds.

The voluntary bankruptcy of the Company was declared by order dated November 5, 2007, date on which the account created in support of the credit policy showed a debit balance in favor of the Bank in the amount of four hundred six thousand ninety-six euros and fifty-four cents (€406,096.54).

Following the declaration of bankruptcy, on November 21, 2007 the Bank notified the Company that it had undertaken a refund transaction dated November 14, 2007, for the entirety of the two thousand nine hundred forty-eight equity shares in the mutual fund and for a net amount of three hundred seven thousand three hundred eighty-five euros and seventy-three cents (€307,385.73), which was transferred to the credit account on November 17, 2007 and applied by the Bank towards the reduction of the debit balance.

The Plaintiff considered that since this was performed on November 17, 2007, date on which bankruptcy had already been declared, that the described offset transaction was in violation of Article 58 of Bankruptcy Act 22/2003, July 9, which establishes that "without prejudice to the provisions of Article 205, following the declaration of bankruptcy, any offset of credits and debts of the insolvent party will not take place, but any offset whose requirements shall have existed prior to the declaration will take effect".

The judicial bodies of the first two instances (Court of First Instance 2 of Segovia and the Segovia Provincial Appellate Court) found in favor of the Plaintiff, since they understood that the offset or, where appropriate, enforcement of the pledge, had in fact taken place after the declaration of bankruptcy whereby they convicted the Bank to reimburse the assets of the Company in the quantity of three hundred seven thousand three hundred eighty-five euros and seventy-three cents (€307,385.73).

They likewise added that the offset requirements of Article 1196 of the Civil Code did not occur prior to the declaration of bankruptcy, among other reasons because the maturity of the credit policy giving rise to the debt, set for January 25, 2008, had not taken place upon the declaration of bankruptcy.

The Bank filed an appeal for cassation before the Supreme Court against the ruling of the Provincial Appellate Court, alleging that the transaction challenged in the claim was not an offset, but rather the enforcement of a pledge on the equity shares in mutual funds property of the

debtor and pledger, and that such enforcement was governed as agreed by both parties, specifically by the contents of Clause Six of the pledge agreement in which, under the heading "enforcement" the following is stipulated:

"(…) for the purpose of the enforcement of the pledge, the pledger hereby expressly and irrevocably grants the Bank the right that corresponds to it to request the refund of the equity shares of the pledged Mutual Funds from the Management Company insofar as necessary for the payment of any quantities owed, providing that these are due, and hereby grants an irrevocable order to the Management Company to accept and execute such request and place the resulting balance at the disposal of the Bank, which may apply this on its own toward settling any obligations deriving from this agreement (…)"

The Bank likewise alleged that such enforcement should not be affected by the declaration of bankruptcy of the debtor Company and holder of the pledged instruments, by virtue of the provisions of Article 15.4 of Royal Decree 5/2005 whose literal meaning is as follows "Financial collateral agreements will not be limited, restricted or in any way affected by the opening of a bankruptcy or administrative winding-up proceedings, and may be immediately and separately enforced as stipulated between the parties and set forth in this section."

The Supreme Court ultimately ruled in favor of the Bank, declaring that the prior instances had not considered the provisions of Royal Decree Act 5/2005, which constitutes a special rule applicable to credit institutions – pursuant to section 3 of additional provision two of Act 22/2003 – and which transposed Directive 2002/47/EC, of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements. And, in particular, Article 15.4 thereof, which establishes that the right of separate enforcement of the collateral, exercised as appropriate by the creditor now appellant, is not limited, restricted or in any way affected by the opening of a bankruptcy proceeding of the pledged debtor.

In conclusion, the Supreme Court declared that the collateral had been enforced as agreed and by virtue of the aforementioned precept, proceeding to uphold the appeal for cassation, act accordingly with the remedy of appeal and dismiss the complaint

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