

Listed Corporations for Investment in the Real Estate Market

The introduction of a new investment vehicle, the Listed Corporations for Investment in the Real Estate Market, with a tax regime inspired by that existing in other jurisdictions, such as Real Estate Investment Trust, intends to reactivate the Spanish Real Estate Market

The Listed Corporations for Investment in the Real Estate Market (*Sociedades Cotizadas de Inversión en el Mercado Inmobiliario* or “SOCIMI”), known under the Anglo-Saxon terminology as Real Estate Investment Trusts (“REITs”), are incorporated into the Spanish legal system for the first time on October 2009 under the Law on Listed Corporations for Investment in the Real Estate Market. This Law introduces a new regime in Spain, including most notably certain features regarding both, the composition of this new investment vehicle and its tax applicable regime, which may be voluntarily chosen by the companies, subject to the fulfillment of certain conditions.

The SOCIMI is a vehicle for investment in the Real Estate Market created with the aim of promoting the rental market in Spain and making it easier for citizens to invest in urban rental properties.

Main features of the SOCIMI

- ◆ The SOCIMI must have a minimum share capital of Euros 15 million.

Their principal corporate purpose must be:

- ✓ The acquisition and promotion of urban based real estate for its leasing.
- ✓ The holding of stock in the capital of other SOCIMI or in the capital of other foreign entities that have the same corporate purpose.
- ◆ Real estate property forming part of the assets of the SOCIMI must remain on lease at least for a period of three years. The same period is requested for the holding of stock in the capital of other SOCIMI or entities that have the same corporate purpose. However, when the real estate has been built by the SOCIMI, the term will be of 7 years.

- ◆ External financing may not exceed 70% of the assets and SOCIMI are obliged to distribute at least 90% of the profit corresponding to income derived from real estate leasing activities and ancillary activities, at least 50% of the profit corresponding to income derived from the transfer of real estate and stock and 100% of the profit derived from dividends from holding the stock in other SOCIMI or entities that have the same corporate purpose.

Special tax regime of the SOCIMI

- ◆ **Requirements for the application of the special tax regime of the SOCIMI**

The special tax regime applied to the SOCIMI is applicable for tax periods beginning as from 1 January 2009.

The option to apply the special tax regime will be adopted by means of a decision by the General Shareholders Meeting; the Tax Authority should be notified of such a decision before the last three months prior to the end of the tax period and will be applicable during such period and successive periods.

In general terms, the special tax regime will be incompatible with the special tax regimes provided under the Spanish Corporation Tax legislation.

The entities which may opt for said special tax regime must comply with the main features mentioned before and satisfy the following requirements:

- ✓ The shares must be accepted for trading in a Regulated Market in Spain or in any other Member State of the European Union, or Member State of the European Economic Area without interruption throughout the entire tax period;
- ✓ 80% of the assets are invested in the main company purpose; In order to ensure adequate diversification of the property investments, entities must hold at least three buildings among their assets, none of which may represent more than 40% of the assets of the entity at the moment when it is acquired;
- ✓ Separate books of account are to be kept for each activity;
- ✓ 80% of the income (excluding that deriving from the transfer of shares and buildings after the end of the minimum holding period) must derive from the leasing of buildings and dividends deriving from holdings in other SOCIMI or entities with a similar corporate purpose.

◆ **Taxation of the SOCIMI**

✓ **Direct taxation**

Tax will accrue on the day upon which the distribution of earnings or reserves for the financial period in which the special tax regime is applicable is determined and the last day of the tax period for earnings subject to the general rate when the SOCIMI has incurred losses or has no distributable earnings, or holds reserves in a form which is other than distributable.

They shall be exempt from tax on 20% of the income proceeding from the leasing of private dwellings upon the condition that 50% of the assets of the company are made up of dwellings, in accordance with the individual balances.

The main peculiarity of the tax regime for the SOCIMIs is that they are taxable at a rate of 18%. Nevertheless, the general tax rate of 30% will be applicable to earnings proceeding from:

- ✓ The sale of buildings or shareholdings when the minimum holding period has not been observed, or when the purchaser is a related entity which forms a part of the same group to the effects of Corporation Tax, or is

resident in a country or territory with which there is no effective exchange of tax information.

- ✓ The leasing of buildings when the tenant is a related entity or is resident in a country or territory with which there is no effective exchange of tax information.
- ✓ Operations which do not produce earnings following the application of the accounting regulations.

Dividends distributed by a SOCIMI are not subject to withholding tax or payments on account, whatever the character of the shareholder receiving the dividends.

All of the deductions and tax credits provided under the Corporation Tax regulations will be applicable, although the deduction for the reinvestment of extraordinary earnings will be applicable exclusively in respect of the sale of buildings and shareholdings related to the main company purpose effected after the minimum holding period has elapsed and this deduction will amount to 6% of the income generated and included within the taxable base of the company.

The SOCIMI should effect fractioned payments on the basis of the tax due for the most recent tax period.

✓ **Indirect taxation**

With respect to Transfer Tax and Stamp Duty on the incorporation and capital increase, a SOCIMI is exempt under the regime of Company Operations. Furthermore, a tax credit of 95% is provided in the Tax payable for the acquisition of dwellings and land intended for development for leasing, upon condition that the minimum holding requirement is satisfied.

◆ **Taxation of the shareholders of the SOCIMI**

✓ **Resident natural persons**

Dividends distributed by a SOCIMI are exempt from Personal Income Tax.

With respect to capital gains and losses obtained in the sale of shareholdings in a SOCIMI: (i) gains will be exempt up to a limit of the positive difference between 10% of the acquisition value

multiplied by the number of years during which the shareholding is held and the special tax regime is applicable and the value of the exempt dividends received during the period the shareholding is held; (ii) losses are only included in respect of that part which exceeds the exempt dividends received during the year prior of the sale of the shareholding.

✓ **Resident or non-resident legal persons permanently established in Spain**

With respect to the dividends distributed against earnings or reserves proceeding from income subject to the tax rate of 18%, the income to be included in the taxable base will be the result of multiplying the income posted for the dividends received by 100/82. The beneficiary will have the right to a deduction from the tax payable of 18% of the income included within the taxable base, or the tax rate applicable to that person if lower.

However, dividends distributed against earnings or reserves proceeding from income subject to the general tax rate will be subject to the general Corporation Tax regime.

Income obtained from the sale of holdings in a SOCIMI will be able to benefit from the application of the deduction in order to avoid double taxation on undistributed earnings subject the following conditions:

- ✓ A deduction of 30% will be applicable to that part of the capital gain which corresponds to the undistributed earnings which were taxable at the general rate.
- ✓ That part of the income which corresponds to earnings proceeding from income subject to the rate of 18% will be included in the taxable base in the same manner as dividends (100/882) and 18% of the amount included may be deducted from the tax payable (or a lower percentage if this is income subject to a lower rate).
- ✓ Non-permanently established non-residents

Dividends distributed by a SOCIMI are considered to be tax exempt income, except where the beneficiary is resident in a tax haven or in a territory classified in the legislation as a tax haven.

That part of the exempt income which derives from the sale of the shareholding will be determined in the same manner as for resident natural persons, except where the seller is resident in a country or territory classified under the legislation as a tax haven.

The remainder of the income will be taxable under the terms established in the Non-Resident Income Tax legislation.

◆ **Other questions relevant to the special tax regime of the SOCIMI**

- ✓ The tax regime applicable to entities which are taxable under the general regime but which opt for the special tax regime and vice-versa, is regulated.
- ✓ It is assumed that all restructuring operations carried out in order to permit the application of the SOCIMI regime are carried out for a valid economic reason to the effects of the application of the special tax regime for mergers governed by the Corporation Tax legislation.
- ✓ The transformation of Real Estate Collective Investment Institutions into SOCIMI and vice versa is permitted.
- ✓ Certain specific duties of information for SOCIMI have been established, which must be included in the report in the annual financial statements. Failure to do so will constitute a tax infringement and will incur a fine.
- ✓ Loss of the special tax regime

The special tax regime will be lost and the entity will become taxable under the general regime in the event that: (i) any of the requirements which are mandatory for opting for the special tax regime are not satisfied; (ii) there occurs a material breach of the duties of information; and (iii) the entity waives the special regime.

Loss of the special SOCIMI regime entails that the entity may not opt for the regime again during a period of five years.

Useful Contacts:

Tax Authority (Agencia Tributaria):

www.agenciatributaria.es

Main relevant legislation:

- ◆ Law 11/2009, of 26 October, Regulating Listed Corporations for Investment in the Real Estate Market
- ◆ Royal Legislative Decree 4/2004, of 5 March, Approving the Consolidated Text of the Law on Corporation Tax
- ◆ Royal Legislative Decree 5/2004, of 5 March, Approving the Consolidated Text of the Law on Non-Resident Income Tax
- ◆ Law 35/2006, of 28 November, on Personal Income Tax for Natural Persons and partial amendment of the Laws on Corporation Tax, Non-Resident Income Tax and Capital Gains Tax
- ◆ Royal Legislative Decree 1/1993, of 24 September, Approving the Consolidated Text of the Law on Transfer Tax and Stamp Duty
- ◆ Consolidated Text of the Law on Limited Liability Companies, as approved by Royal Legislative Decree 1564/1989, of 22 December
- ◆ Law 24/1988 of 28 July, on the Securities Market