# THE REAL ESTATE INVESTMENT STRUCTURE TAXATION REVIEW

SECOND EDITION

**Editors**
Giuseppe Andrea Giannantonio and Tobias Steinmann

THE LAWREVIEWS

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# CONTENTS

# PREFACE

The real estate sector plays a crucial role in the global economy and social environment.

In particular, the commercial property sector offers the infrastructure needed for the growth and development of entrepreneurship and business, including offices, shops, industrial and logistics premises, and hotels. In Europe alone, commercial real estate represents a business of €7 trillion.

Business operators often prefer to rent the spaces used for carrying out their activity. Therefore, commercial properties are generally held as investments by third-party investors, who buy commercial properties and rent them to business operators.

The real estate sector is also a fundamental source of employment. In 2017, the European real estate sector employed 4 million people, more than the car manufacturing and telecommunications sectors combined. Moreover, it provides residential accommodation and is seen as a tool to meet social and public needs. New types of properties are emerging and have increasingly been included in investment portfolios, such as healthcare, senior living, education and student accommodation.

In this context, attracting new resources and investment from institutional investors such as pension funds, insurance companies and sovereign wealth funds is important for the improvement of the real estate sector. In particular, it is desirable that those investors are involved in both financing large development projects and investing in properties held for rent.

Based on market practice, investments from foreign institutional investors are mainly carried out indirectly rather than through direct acquisitions, and especially through non-listed real estate funds, listed property companies and real estate investment trusts.

The pandemic emergency caused by covid-19 in this first half of 2020 has also affected the real estate sector. Although, generally, any disturbance to private real estate valuations is normally only revealed over time, listed real estate stocks suffered sharp falls in Q1 2020. This is because of the role the sector plays in the real economy and for this specific reason it is widely considered that the coronavirus crisis may also have lasting effects on real estate usage; for example, because new public health regulations will be introduced. Accordingly, the post-crisis landscape could be characterised by higher demand in alternative real estate sectors and for alternative assets, accelerating a process of transformation that was already ongoing. It is considered therefore that, in the long run, this will all contribute to the fundamental attractiveness of real estate as a long-term investment asset class.

We agree that within Europe, the role of the real estate sector as an economic, employment and social catalyst needs to be supported by a legislative framework that increases transparency and competitiveness, and simplifies and standardises bureaucratic processes.

However, within the European Union, the differing impact of the covid-19 crisis is exacerbating differences between the interventions made by legislators in the individual jurisdictions, with allowances, tax credits and other tax provisions introduced and applied very differently from one state to another. Generally, these disparities reflect the level of impact the pandemic has had in particular jurisdictions, the economic policies followed by their respective governments and the level of resources available to achieve those aims.

Correlatively, national legislators will need to adapt any new provisions to those pre-existing types of specialised real estate investment vehicles that currently benefit from tax exemptions or other advantageous tax allowances, for both direct and indirect tax purposes.

Given this presently rather fragmented scenario, the aim of this volume is to provide a useful guide to those international and institutional investors willing to invest in real estate properties located in Europe, and to illustrate in a comparative manner possible alternatives for the establishment of investment platforms in Europe and investment vehicles at a local level. In particular, each country-specific chapter provides insights from leading experts on key tax considerations and investment opportunities based on the relevant national legislation. Furthermore, in this edition, we have sought to provide indications of any allowances and facilitations introduced temporarily in response to the current economic crisis that may also present investors with investment opportunities in specific countries.

We would like to thank the authors of this volume for their extensive expertise and for their efforts to ensure the successful outcome of this work. We hope that the reader finds this volume useful and we welcome any comments and suggestions for its improvement.

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June 2020

Chapter 8

# PORTUGAL

*Diogo Ortigão Ramos and Gonçalo Bastos Lopes*[1]

## I OVERVIEW

### i Investment vehicles in real estate

The most commonly used vehicle to invest in real estate in Portugal is the company limited by shares or joint-stock company (SA), which is an unregulated flexible vehicle that does not attract significant incorporation costs or ongoing management and compliance costs.

Depending on the actual features of the investment, such as the investor's origin or the dimensions and composition of the investment's portfolio, the use of more than one SA as a special purpose vehicle held by a local holding company may be appropriate.

Regulated vehicles such as real estate investment funds (FIIs) may also constitute attractive investment vehicles, although these are not so commonly used owing to their highly regulated regime, which includes special requirements and limits regarding, for example, risk spreading and leverage, and higher management and compliance costs.

### ii Property taxes

The direct acquisition of real estate is subject to property transfer tax (IMT) and to stamp duty. The constitution, transfer or termination of minor *in rem* rights such as the usufruct or surface rights are also liable for IMT and stamp duty.

As a rule, the transfer of real estate is exempt from value added tax (VAT). However, under certain conditions the seller (together with the buyer) may waive the VAT exemption on the transfer of urban non-residential real estate, in which case no stamp duty is due.

The holders of the ownership, usufruct or surface right over real estate are liable for the payment of an annual municipal real estate tax (IMI); an additional tax (AIMI) is also due on residential property and land for construction.

Rental income and capital gains derived from the transfer for a consideration of real estate located in Portugal are generally liable for income taxes if obtained either by individuals or by companies or other entities, whether resident or non-resident for tax purposes in Portugal.

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1 Diogo Ortigão Ramos and Gonçalo Bastos Lopes are partners at Cuatrecasas. The authors would like to acknowledge the contribution of their colleague Paulo Costa Martins on the regulatory framework of regulated investment vehicles.

## II ASSET DEALS VERSUS SHARE DEALS

### i Legal framework

The transfer of rights over real estate can be direct, namely through direct acquisition of an asset (an asset deal), or indirect, through the transfer of shares of the company or other vehicle owning the property (a share deal).

***Asset deals***

The purchase and sale of real estate is done by means of a public deed, executed and signed before a notary public, or by a private document certified by a person or entity legally qualified for this procedure; for example, a notary public, a lawyer or a registry officer.

Apart from compliance with the tax obligations resulting from the acquisition of the real estate, several documents may be required for the transfer of property ownership and, depending upon the circumstances, these may include the property's energy performance certificate, the residential technical document or the use permit issued by the municipality.

Although the transfer of *in rem* rights over real estate occurs upon the execution of the underlying agreement, the transfer must be registered to ensure a public disclosure of the legal condition of the assets and guarantee the lawfulness of the property transaction.

***Share deals***

Share deals are usually formalised through private agreements that do not need to be notarised. Under these agreements, the parties agree on the terms and conditions for the transfer of shares, which generally include specific provisions on the real estate owned by the seller (e.g., representations and warranties, and conditions precedent).

The legal requirements for the transfer of shares depend on the type of investment vehicle.

***Ownership***

The right of ownership is governed by the Portuguese Civil Code and is the highest *in rem* right over real estate in Portugal. According to the legal definition, the owner of a property fully and exclusively enjoys the rights of use, fruition and disposal of real estate, within the legal limits.

A property may be owned individually by a single person or jointly by two or more persons, designated as co-owners, under a co-ownership regime. Under this regime, the co-owners simultaneously hold the right of ownership over the same asset, exercising their rights and obligations in proportion to their respective quotas.

In Portuguese law, it is also possible to divide a building into several independent units, under the horizontal property regime. Under this regime, the units are owned separately and may belong to different owners. The common areas of a building divided under the horizontal property regime are co-owned by all owners of the units. The division under the horizontal property regime may also apply to separate buildings or complexes under certain conditions.

There are other lawfully established *in rem* property rights, such as the surface right. This right, which does not include ownership of the land, consists of the legal right of building or keeping, permanently or temporarily, a construction on land owned by a third party, or to plant on it. At the end of the term of a temporary surface right, the building erected on the land will revert to the landowner.

Any facts that create, recognise, acquire or modify any rights over real estate are subject to mandatory registration with the land registry office, which also records the description of the property. The effects of such facts against third parties depend on this registration. Moreover, according to the principle of priority of registration, a right registered in first place prevails over any conflicting rights or acts registered subsequently.

### ii Corporate forms and corporate tax framework

***Corporate forms***

When setting up a business in Portugal, foreign investors generally incorporate or acquire a limited liability company. The two main types of companies with limited liability in Portugal are SAs, which are public limited liability companies, and LDAs, which are private limited liability companies. Both have legal personality separate and distinct from that of their shareholders, who are not personally liable for the company's debts.

The SA is the preferred vehicle for real estate investments since the transfer of shares of an SA triggers no indirect taxes, whereas the acquisition of 75 per cent or more of the share capital of an LDA that owns real estate triggers property transfer tax.

Portuguese law also provides the option to invest through partnerships, namely the general partnership, the limited partnership and the limited partnership with share capital. These are all incorporated entities with legal personality separate from that of their partners.

***CIT framework***

As a rule, all companies engaged in a business undertaking are taxable entities, liable for corporate income tax (CIT) under general rules, regardless of the legal form that they adopt, whether the LDA, the SA or partnerships.

Nonetheless, in certain cases companies are tax transparent for CIT purposes. This is the case, for instance, with companies 'of simple management of assets' that are either controlled by a family-owned group or are owned by not more than five shareholders.[2]

### iii Direct investment in real estate

***Indirect taxes on purchase***

*IMT*

The acquisition of real estate for a consideration is subject to IMT, levied on whichever is the higher of the property's transfer value or its fiscal value registered with the tax authorities (VPT). IMT is payable by the purchaser.

A 5 per cent IMT rate applies to the acquisition of rural land. The highest rate applicable to the acquisition of urban property is 7.5 per cent (6.5 per cent for non-residential property). A 10 per cent rate applies regardless of the nature of the property if the purchaser is an entity (not an individual) with a residence or head office in a country, territory or region subject to a more favourable tax regime included in a list of blacklisted jurisdictions approved by an order of the Minister of Finance.[3]

IMT is also due upon the formation, transfer or cancellation of minor *in rem* rights over real estate, such as usufruct and surface rights, at the same taxation rates applicable to the transfer of ownership but subject to special rules to determine the tax base.

2 See below on the direct taxes applicable during the investment regarding resident companies.

3 Ministerial Order 150/2004, of 13 February, as amended by Ministerial Order 292/2011, of 8 January.

Investors should take care when preparing the acquisition and drafting the supporting contractual documentation because under certain conditions IMT is also levied upon the signature of a promissory purchase and sale agreement, upon the transfer of the contractual position of the promissory purchaser in such an agreement, or upon the granting or transfer of a proxy granting irrevocable powers to sell real estate.

The two main IMT exemptions generally available to investors are as follows.

*Resale exemption*

The acquisition of real estate for resale purposes by a company whose corporate purpose is the acquisition and sale of real estate, and the resale of real estate acquired for that purpose, may benefit from an IMT exemption.

To benefit from this exemption, the purchaser should declare the acquisition to have been made with a view to resale and should resell the real estate without it being the object of substantial changes or different allocation, within three years of the acquisition, to a buyer who is not acquiring it with the aim of also reselling it.

This exemption may be obtained up front (and not by means of a subsequent refund) if the purchaser demonstrates that it usually carries on this activity, by means of a statement issued by the Portuguese tax authorities attesting that in the preceding calendar year the purchaser resold at least one property previously acquired with the aim of reselling or that it acquired a real estate asset with the aim of reselling it.

*Urban rehabilitation exemption*

An IMT exemption may apply to the acquisition of real estate for urban rehabilitation purposes for properties that were constructed more than 30 years ago or that are located in an official urban rehabilitation area.

The beginning of rehabilitation work should occur within three years of acquisition, and the works undertaken should qualify as urban rehabilitation work under the terms of the General Regime of Urban Rehabilitation or the Extraordinary Regime of Urban Rehabilitation. Moreover, the grade of preservation of the property needs to increase two levels and a minimum rating of 'good' needs to be obtained. Legal requirements on energy efficiency and thermal quality should be observed.

This exemption operates by means of a refund and is not obtained up front. For this purpose, owners of the property must apply for recognition of the urban rehabilitation work (and, consequently, the underlying exemption) upon submission of the prior notice of the rehabilitation work or the petition for the licensing of the urban rehabilitation work.

The municipality concerned is obliged to communicate this recognition to the relevant tax office for the property within 20 days of the assessment of the property preservation grade after whichever of the works or the issuing of the energy efficiency certificate occurs the later.

An IMT exemption may apply on the first transfer of the property following the rehabilitation works if it is allocated to be let for permanent residency, or, under certain conditions, intended for permanent residency purposes.

*Stamp duty*

The acquisition of the ownership or other minor *in rem* rights over real estate is also liable for stamp duty, at a rate of 0.8 per cent. The tax base is identical to that of IMT: whichever is the higher of the property's transfer value or its VPT.

*VAT*

As a rule, the transfer of Portuguese real estate is VAT-exempt, meaning that no VAT is charged upon the sale thereof. However, under certain conditions, the seller (together with the buyer) can waive the VAT exemption.

The following are the main requirements that should be met for the VAT exemption to be waived:

*a* The real estate must be an urban property or an independent part thereof that does not have a residential use, namely only commercial and industrial buildings and plots of land for construction.

*b* Both the seller and the buyer have to be VAT taxable persons that carry out activities for which they are entitled to deduct input VAT or, where they simultaneously undertake activities in respect of which VAT is deductible and those in respect of which VAT is non-deductible, the former activities represent at least 80 per cent of their business turnover in the preceding year. This 80 per cent criterion does not apply to VAT taxable persons who primarily carry out activities relating to the construction and reconstruction or acquisition of real estate for resale or rental purposes.

*c* The real estate must be used for activities in respect of which input VAT is deductible, namely, transactions liable to and not exempt from VAT.

*d* The circumstances of the real estate should match one of the following situations:
- it is the first transfer after construction, and input VAT on construction has been or may still be totally or partially deducted;
- it is the first transfer after extensive renovation or transformation (i.e., the increase of the VPT of the property by more than 30 per cent), and input VAT incurred on the renovation or transformation may still be totally or partially deducted; or
- it is the first transfer following a transaction where the VAT exemption was waived and the 20-year adjustment period of the initial deduction of the input VAT has not yet expired.

***Indirect taxes during the investment***

*IMI*

The holders of the ownership, usufruct or surface right over real estate are liable for the payment of IMI on an annual basis.

IMI is due on the VPT of the property, at rates that vary from 0.3 per cent to 0.45 per cent for urban properties, and at 0.8 per cent for rural properties, as decided on an annual basis by the municipality. IMI is assessed and due by reference to the owner as at 31 December of the relevant year, and is collected and paid in the subsequent year.

Under certain conditions and upon proper notification to the tax authorities, real estate held with a view to resale and accounted for as inventory and stock is only liable for IMI from the third year after the acquisition, unless the property is acquired from an entity that has already benefited from this tax deferral regime. This deferral regime may also apply to property not acquired with a view to resale but accounted for as inventory or stock.

Subject to the same terms and conditions referred to above regarding the IMT urban rehabilitation exemption, real estate subject to urban rehabilitation can also benefit from an IMI exemption for three years, counted from (and including) the year of conclusion of the works. This exemption may be extended upon request for an additional five years in respect of property allocated to be let for permanent residency purposes or intended for permanent residency purposes.

*AIMI*

In addition to IMI, the holders of the ownership, usufruct or surface right over urban real estate are also liable for the annual payment of AIMI tax.

AIMI is due on urban property with the exception of property licensed or classified as commercial, industrial, services or other property, meaning that it applies to residential property and plots of land for construction.

AIMI is due on the VPT of non-excluded properties as at 1 January each year. The rate generally applicable to companies or assimilated entities is 0.4 per cent, except for those domiciled in blacklisted jurisdictions, to which a 7.5 per cent rate applies.

No AIMI applies to properties that in the previous year benefited from an IMI exemption or from an IMI tax deferral (see above).

***Direct taxes during the investment and on exit***

When dealing with CIT on income arising during the holding and upon disposal of real estate investments, one should distinguish between non-residents without a permanent establishment (PE) in Portugal and those operating in Portugal through a PE or a local subsidiary.

*Non-residents without a PE*

The concept of the PE set out in Portuguese domestic CIT law and in the double tax treaties concluded by Portugal is in line with the definition contained in Article 5 of the Organisation for Economic Co-operation and Development Model Tax Convention on Income and on Capital (the OECD Model Tax Convention).

Therefore, non-residents investing directly in the acquisition of Portuguese real estate will not be deemed as having a PE if they do not engage in a related active business activity but rather limit their investment to the holding of the property and the collection of rents arising from the corresponding lease without any services provided in relation to it.

The income obtained during the holding of the investment and on sale is liable for Portuguese CIT, pursuant both to the provisions of the double tax treaties concluded by Portugal and domestic tax law.

Income derived from the lease of the property is liable for CIT at a rate of 25 per cent. Taxable income corresponds to the gross income minus all related costs and expenses, with some exceptions. In particular, deduction of financial costs and depreciation is not allowed.

Where the lessee is a Portuguese entity bound to maintain accounting records, the gross rental income is subject to withholding tax at a rate of 25 per cent, which constitutes an advance payment of the final CIT due. To compute the year's final CIT liability, the non-resident investor shall file an annual CIT return.

Capital gains obtained upon disposal of real estate property are also liable for CIT in Portugal at a rate of 25 per cent.

The taxable gain corresponds to the positive difference between the transfer value and the acquisition value of the property. The acquisition value should be augmented by expenses incurred on property improvements in the 12 years prior to the transfer.

To the extent that the property is transferred more than 24 months after the acquisition date, the acquisition value is adjusted by a monetary correction coefficient.

If the property's VPT is higher than the declared transfer value, the VPT shall be the relevant value for capital gains purposes unless, within a special procedure that grants the tax authorities access to the bank accounts of the seller and its board members, the transferor provides evidence that the transfer value was actually lower than the VPT.

Under domestic tax law, capital gains obtained by a non-resident entity upon transfer of the shares in another non-resident company more than 50 per cent of whose value, at any time during the 365 days prior to the transfer, derives directly or indirectly from real estate in Portugal is liable for Portuguese CIT, except when the property is used in a business undertaking other than the purchase and sale of real estate.

Depending upon the circumstances, actual taxation over these capital gains may be overridden pursuant to the provisions of a double tax treaty concluded between Portugal and the state of residence of the transferor.

If CIT taxation is actually due, a rate of 25 per cent applies on the positive difference between the shares' transfer value and the shares' acquisition value (updated by a devaluation coefficient if the shares have been held for more than 24 months).

*Non-residents with a PE*

Under domestic law, Portuguese PEs of non-residents are liable for CIT on their income, defined as the income obtained through the PE and other income derived in Portugal from activities identical or similar to those undertaken through the PE. However, under double tax treaties concluded by Portugal, this domestic rule is overridden and the taxable income of the PE corresponds exclusively to that obtained through the PE itself.

The CIT taxable profit of a PE is generally computed in accordance with rules similar to those applicable to resident companies (see below). In practice, a PE will normally imply the registration of a branch, which has no legal existence separately from that of the head office. Although the PE is treated in principle as a separate fiscal entity, some exceptions apply.

Under Portuguese domestic law, no CIT is levied on the profits remitted by the PE to the head office.

*Resident companies*

*Tax rates*

The standard CIT rate is 21 per cent. A state surcharge is also levied on the year's taxable profits (i.e., before deduction of tax losses from prior years) exceeding €1.5 million at the following progressive rates:

*a* 3 per cent for taxable profits in excess of €1.5 million;
*b* 5 per cent for taxable profits in excess of €7.5 million; and
*c* 9 per cent for taxable profits in excess of €35 million.

Most municipalities also levy a local surcharge on the year's taxable profits, at rates of up to 1.5 per cent.

*Tax losses*

The carry-forward period for tax losses is five years for losses incurred in tax periods starting on or after 1 January 2017, except for micro, small and medium-sized enterprises, to which a 12-year carry-forward period applies.

However, the deduction of tax losses from prior years is capped at 70 per cent of the taxable profits of each tax period.

The right to carry forward tax losses may in certain cases be jeopardised when the ownership of more than 50 per cent of the share capital or voting rights changes.

*Taxable income*

The annual CIT tax base for resident entities engaged in a business undertaking results from the accounting profit or loss of the year added by certain positive and negative changes in equity not reflected in the profit-and-loss account, which is subject to certain adjustments required by the CIT law.

According to the general rule, all expenses and losses documented and incurred in the course of the business activity shall be accepted as deductible for CIT purposes.

The terms and conditions of transactions (such as intragroup funding) between related parties should follow those that independent entities in a comparable transaction would establish (arm's length), pursuant to the domestic transfer pricing rules that follow the OECD guidelines.

According to the Portuguese interest barrier rule, net financial costs are deductible only up to whichever is the higher of €1 million or 30 per cent of earnings before interest, tax, depreciation and amortisation (EBITDA) (as adjusted for tax purposes). Net financial costs that cannot be deducted in a given tax period may be carried forward for five years. Likewise, if the net financial costs, which are deductible in a given year, do not reach 30 per cent of the EBITDA, the unused deduction allowance may be carried forward for five years.

While real estate accounted for as stock or inventory is not subject to depreciation, the annual cost of depreciation of real estate accounted for as investment property under the cost model or as tangible fixed assets is accepted as a deductible cost for CIT purposes.

Land is not subject to depreciation and when the land's value is not known, 25 per cent of the acquisition value shall be allocated to the land.

As regards buildings, depreciation rates range from 2 per cent (residential and commercial properties) to 5 per cent (industrial properties, restaurants, hotels, etc.). Depreciation of equipment (if any) needs to be assessed on a case-by-case basis, depending on the underlying type of property, at rates that vary from 5 to 50 per cent. Major repairs and improvement works (defined as those that increase the value or duration of the assets that are the object of the works) may be depreciated during the expected lifetime period.

The disposal of real estate accounted for as investment property or as tangible fixed assets gives rise to capital gains or capital losses, which are included in the CIT taxable income of the company.[4] Capital gains or losses arise from the difference between the transfer value – net of inherent costs – and the acquisition value minus depreciation and impairment losses accepted for tax purposes. A monetary correction coefficient applies to the net acquisition cost of real estate held for more than two years.

Whenever the property's VPT is higher than the declared transfer value, the former will be the relevant value for CIT purposes, both at the level of the seller and the buyer. The seller may, however, demonstrate to the tax authorities that the transfer value was actually lower than the VPT of the property, although it would be required to grant the tax authorities access to its bank accounts and to the bank accounts of its directors.

*Tax transparency*

Resident companies investing in real estate may be tax transparent for CIT purposes; for example, companies of simple management of assets that are either controlled by a family-owned group or are owned by not more than five shareholders. These are companies

4 There is no separate taxation of capital gains or losses in Portugal.

that limit their activity to the administration of assets or securities held as an investment or for enjoyment, or to the purchase of buildings for the housing of their shareholders, as well as companies that also carry on other activities but whose revenue from those assets, securities or properties reaches an average over the previous three years of more than 50 per cent of the total revenues.

Pursuant to the tax transparency regime, the company's taxable income is computed under general rules, but the taxable profits (not tax losses) are allocated and taxed at the level of the holders of the capital.

Non-resident shareholders are deemed to have a PE in Portugal, for the sole purpose of allocating the taxable income of the Portuguese tax transparent company.

### iv Acquisition of shares in a real estate company

#### *Indirect taxes on purchase*

The acquisition of 75 per cent or more of the capital of an LDA, a general partnership or of a limited partnership is subject to IMT whenever these companies own real estate.

Regardless of the type of real estate owned (e.g., rural or urban), IMT is levied at a rate of 6.5 per cent on whichever is the higher of the property's book value and its VPT, in proportion to the stake acquired. IMT is payable by the purchaser.

No such levy is due upon the acquisition of shares in an SA owning real estate, which constitutes a significant difference in favour of this type of vehicle compared with the LDA.

The acquisition of shares in a Portuguese company is VAT-exempt and does not trigger the payment of any other indirect taxes.

#### *Withholding tax on dividends*

Under Portuguese domestic tax rules, dividends from a Portuguese resident company due to a non-resident parent company are liable for withholding tax at the domestic rate of 25 per cent.

If the recipient of the dividends is entitled to the benefits of a double tax treaty concluded between Portugal and its state of residence, the withholding tax rate may be reduced, typically to 15 or 10 per cent.[5]

Under the Portuguese participation exemption regime, dividends paid by a Portuguese resident subsidiary to a non-resident parent company may benefit from a withholding tax exemption if the following conditions are met:

*a* the Portuguese subsidiary paying the dividends is subject to and not exempt from Portuguese CIT and is not taxed as a CIT transparent entity; and

*b* the parent company:[6]

- is resident in another EU Member State, in a European Economic Area (EEA) Member State bound by an administrative cooperation procedure in tax matters

5 Applicability of the double tax treaty is subject to certain administrative requirements. To benefit up front from withholding tax relief, the income's recipient shall provide the Portuguese paying entity with an official form (Form 21-RFI) either completed and certified by the foreign tax authorities or accompanied by a certificate issued by the foreign tax authorities attesting the recipient's tax residency and its status subject to tax in its state of residence.

6 To qualify for the participation exemption regime, the parent company must provide the Portuguese subsidiary with adequate evidence that the necessary requirements have been met. To comply with

similar to that established within the European Union, or in a country that has concluded a double tax treaty with Portugal providing for the exchange of information for tax purposes;[7]
- is subject to and not exempt from one of the taxes referred to in Article 2 of the Parent-Subsidiary Directive,[8] or is subject to a tax similar to Portuguese CIT with a nominal tax rate not lower than 12.6 per cent;[9] or
- holds, directly or indirectly, a stake of at least 10 per cent in the capital or voting rights of the Portuguese subsidiary, for an uninterrupted period of at least one year prior to the distribution date of the dividends.

If the one-year minimum holding period has not yet elapsed when dividends are paid or made available (the relevant event for withholding tax purposes), withholding tax applies and as soon as that period is complete, the parent company may apply for a refund of the tax withheld.

However, the participation exemption does not apply if there is an arrangement or a series of arrangements that have been put in place with the main purpose (or one of the main purposes) being to illegitimately benefit from the participation exemption, which facilitates avoidance of double taxation (i.e., arrangements aimed at applying the exemption in cases where there is no double taxation), and that are not genuine having regard to all relevant facts and circumstances. For this purpose, an arrangement may comprise more than one step, and may be an arrangement or a series of arrangements regarded as not genuine to the extent that they are not put in place for valid commercial reasons that reflect economic reality.

The participation exemption also does not apply if the Portuguese subsidiary does not comply with the corporate obligation of maintaining a register of the ultimate beneficial owner (UBO), or if the register is complied with but the UBO is a tax resident of a blacklisted jurisdiction and the Portuguese company is not capable of demonstrating that the structure was put in place for sound business reasons (i.e., where the company cannot prove that the structure does not relate to an arrangement or a series of arrangements with the main purpose (or one of the main purposes) being to illegitimately exploit the exemption provided for the avoidance of double taxation, and that are not genuine having regard to all relevant facts and circumstances).

### *Taxation of capital gains*

Capital gains derived by non-resident entities from the transfer of shares in a Portuguese resident company whose assets mainly consist of real estate located in Portuguese territory are liable for Portuguese CIT under domestic tax law.

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requirements, the parent company must provide the Portuguese subsidiary with a declaration issued by the foreign tax authorities attesting the parent company's tax residency and its status subject to tax in its state of residence.

7 For this purpose, resident status of the parent company shall result from the domestic provisions of the relevant state, and it shall not be considered resident in any other state pursuant to the provisions of a double tax treaty concluded by that state.

8 Council Directive 2011/96/EU of 30 November, on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

9 Not lower than 60 per cent of the standard CIT rate, which is currently 21 per cent.

Unlike resident investors, non-resident investors are not eligible for taxation relief on these capital gains, even where the property is used in a business undertaking other than the purchase and sale of real estate. There is a unresolved question as to whether this is a breach of EU law, as it could constitute discrimination against non-resident investors. Depending upon the circumstances, the actual taxation may be overridden pursuant to the provisions of a double tax treaty concluded between Portugal and the state of residence of the transferor.

If CIT taxation is actually due, a rate of 25 per cent applies on the positive difference between the shares' transfer value and their acquisition value (adjusted by a devaluation coefficient if the shares were held for more than 24 months).

### v Funding of the investment

#### *Equity funding*

Equity contributions made by shareholders to a Portuguese subsidiary, as well as the reimbursement of the corresponding amount, are not liable for direct or indirect taxation in Portugal, whether made to subscribed share capital or by means of supplementary capital contributions.[10]

#### *Debt funding*

*Stamp duty*

The granting of credit by any means, including by way of assignment of credits whenever the assignment involves any kind of transfer of funds or financing to the assignee, is subject to stamp duty on the use of credit.

Within the context of cross-border transactions, taxation is levied whenever it involves Portuguese-resident companies acting as borrowers and, as a rule, third-party loans and intragroup financing are subject to stamp duty.

As a rule, stamp duty is a one-off tax imposed on the use of credit and due and payable by the relevant borrower or beneficiary of the funds at the moment when the funds are raised, and applicable in respect of the notional amount of the credit at the following rates:[11]

- *a* 0.04 per cent per month or a fraction thereof for credit granted for a term of less than one year;
- *b* 0.5 per cent for credit granted for a term equal to or over a year and up to five years; and
- *c* 0.6 per cent for credit granted for a term equal to or over five years.

In addition to its imposition on the use of credit, stamp duty may also apply to interest (at 4 per cent of the relevant amount), fees, charges or other commissions (3 per cent or 4 per cent of the relevant amount) for third-party financing. As a rule, where the transaction

10 In the case of LDAs, supplementary capital contributions and, in the case of SAs, ancillary contributions in the form of supplementary capital contributions, which are non-remunerated contributions in cash made by shareholders that can only be reimbursed if the company's equity does not become inferior to the sum of the share capital and the legal reserve.

11 Where the term for the use of credit is not determined or cannot be determined, which is typically the case in overdrafts and current accounts, stamp duty is payable on a monthly basis, at the rate of 0.04 per cent imposed on the monthly average of the inter-company balance (calculated by the sum of the daily balances divided by 30).

is not entered into nor intermediated by a credit institution, financial company, assimilated entity or by any other financial institution, no stamp duty is due on interest, fees, charges or commissions.

Stamp duty is, under the law, to be borne by the entity using the credit or paying the interest, fees, charges or other commissions. Exemptions are available for intragroup funding, notably to credit granted pursuant to subordinated shareholders' loans. This exemption is applicable to credit with a term greater than one year that has the characteristics of a supply contract, granted by a parent to a subsidiary, provided that a minimum 10 per cent stake has been held for an uninterrupted one-year period prior to the granting of credit or since the incorporation of the borrower as long as the stake is held for at least one year. Moreover, credit granted under this exemption cannot be repaid before one year has elapsed since its granting.

Funding raised through the issuing of bonds is not liable for stamp duty, although taxation may arise if security is granted in relation thereto. The granting of security is also subject to stamp duty whenever granted in the Portuguese territory for the benefit of a Portuguese resident entity, or if the security is presented in the Portuguese territory to produce legal effects. The granting of security is, however, excluded from taxation if materially accessory to a taxable stamp duty event and granted simultaneously with it.

When due under the rules identified above, the stamp duty tax base is the value of the underlying security (i.e., maximum secured amount, which is normally higher than the amount of the loan), being the effective tax rate dependent on the applicable term, as follows:

*a* 0.04 per cent per month or fraction thereof for security with a term of less than one year;
*b* 0.5 per cent for security with a term of one to five years; and
*c* 0.6 per cent for security with a term of five years and over or without any specific term.

Under the law, stamp duty is borne by the entity required to grant the guarantee.

*Withholding tax on interest*

Under domestic tax rules, interest due from a Portuguese resident company to a non-resident company is liable for withholding tax, at a rate of 25 per cent.

However, if the recipient of the interest is entitled to the benefits of a double tax treaty concluded between Portugal and the recipient's state of residence, the withholding tax rate may be reduced to the treaty rate, typically 15 or 10 per cent.[12]

Under domestic rules transposing the EU Interest and Royalties Directive,[13] interest due from a Portuguese resident company may benefit from a withholding tax exemption, if the beneficial owner of the interest payment is a company of another EU Member State.[14]

12 Certain documentary obligations must be met to benefit from withholding tax relief under a double tax treaty: the income recipient must provide the Portuguese paying entity with an official form (Form 21-RFI) either completed and certified by the foreign tax authorities or accompanied by a certificate issued by the foreign tax authorities attesting the recipient's tax residency and its status subject to tax in its state of residence.

13 Council Directive 2003/49/EC of 3 June, on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

14 For these purposes, the recipient of the interest is deemed the beneficial owner if it receives the interest in its own name and account and not as an intermediary.

For these purposes, the following conditions should be met:[15]

*a* both companies are subject to one of the income taxes listed in Article 3 of the Interest and Royalties Directive without benefiting from an exemption;
*b* both companies are in one of the corporate forms listed in the Annex to the Interest and Royalties Directive;
*c* both companies are deemed tax residents of an EU Member State, without being deemed tax resident in a third country under a double tax treaty; and
*d* the companies are considered associated entities, which is deemed verified whenever:
  - a company holds a direct minimum stake of 25 per cent in the other company, or a third company holds a direct minimum stake of 25 per cent in both the beneficiary company and the payer company; and
  - a minimum two-year uninterrupted holding period is met.

If this minimum holding period has not yet elapsed upon the interest maturity or payment date (the relevant event for withholding tax purposes), withholding tax applies, and as soon as this period has completed, the interest's recipient may apply for the refund of the tax withheld.

Where, by reason of a special relationship between the payer and the beneficial owner of the interest, or between one of them and some other person, the amount of the interest exceeds the amount that would have been agreed by the payer and the beneficial owner in the absence of such a relationship, the Directive does not apply to the excess interest. Moreover, the Directive does not apply where the majority of the share capital or of the voting rights of the beneficial owner is held, directly or indirectly, by residents of third countries, except if it is demonstrated that the chain of corporate participations does not have as one of its main objectives the reduction of the withholding tax rate.

Under a commonly used special regime,[16] non-residents may also benefit from an exemption from withholding tax on interest derived from listed bonds, namely bonds integrated in a centralised system for securities managed by an entity resident for tax purposes in Portugal (i.e., Interbolsa), or by an international clearing system managing entity established in another EU Member State (i.e., Euroclear and Clearstream Luxembourg) or in an EEA Member State, provided it is bound by an administrative cooperation procedure in tax matters similar to the one established within the European Union or integrated in other centralised systems.[17]

## III REGULATED REAL ESTATE INVESTMENT VEHICLES

### i Regulatory framework

In Portugal, regulated real estate investment vehicles are subject to the legal framework set out in Law No. 16/2015 of 24 February 2015, which transposed into the Portuguese legal order Directive 2011/61/EU of 8 June 2011, and Directive 2013/14/EU of 21 May 2013. Real

15 Certain documentary obligations must be met to benefit from the withholding tax exemption under the Interest and Royalties Directive: the recipient of the interest must provide the Portuguese paying entity with an official form (MOD 01-DJR) either completed and certified by the foreign tax authorities or accompanied by a certificate issued by the foreign tax authorities attesting the recipient's tax residency and its status subject to tax in its country of residence.

16 This regime is set out in Decree-Law 193/2005, of 7 November 2005, as amended.

17 In the last case, the competent government official must authorise the application of the special tax regime.

estate investment vehicles are also subject to CMVM Regulation No. 2/2015, promulgated by the Portuguese Securities Market Commission (CMVM). These regulated vehicles take the form of undertakings for collective investments (UCIs), either of a contractual or corporate nature.

### ii Overview of the different regulated investment vehicles

In general terms, real estate investment vehicles fall into two categories:

*a* the real estate investment fund (FII) – a regular investment fund either established under a contractual (REIF) or corporate form (REIC); and
*b* the real estate special investment fund – similar to a FII, but with a more flexible legal regime as to the eligible assets, investment policy and indebtedness.

Both FIIs and FEIIs can be either open-ended or closed-end funds. In the case of REICs, open-ended funds are designated as variable capital investment companies (SICAVIs) and closed-end funds as fixed capital investment companies (SICAFIs). Despite the structural differences, the legal regime of a SICAFI is that of a closed-end REIF, while a SICAVI follows the legal regime of an open-ended REIF.

The most significant differences between open-ended and closed-end FIIs concern the investment policy (which is stricter in open-ended vehicles than in closed-end vehicles, and stricter in public-subscription closed-end vehicles than in private-subscription closed-end vehicles); indebtedness (a higher threshold applies to closed-end FIIs); duration (open-ended FIIs are not subject to a fixed term); and investors' rights (which are severely limited in open-ended FIIs compared to closed-end FIIs; for instance, in closed-end FIIs, structural matters specified in the management rules and regulations are subject to investor approval by way of resolutions).

REICs can be self-managed or managed by a third party, whereas REIFs must always appoint an external management company. Furthermore, a minimum threshold regarding the share capital applies only to REICs and not to REIFs.

### iii Tax payable on acquisition of real estate assets

No special rules currently apply regarding taxes on the acquisition of real estate assets, including IMT, stamp duty and VAT, by REIF or REIC.[18]

### iv Tax regime for the investment vehicle

***Corporate income tax***

Portuguese FIIs[19] are subject to general CIT, but with some specific rules. The taxable income is based on the profit of the year computed under the specific accounting rules applicable to this type of entity, but most of the income that FIIs normally obtain is CIT-exempt.

18 It is debatable, however, whether a FII might benefit from the IMT exemption, and the IMI and AIMI tax deferral, regarding real estate acquired with the a view to resale. Moreover, MT is also levied upon acquisitions of 75 per cent or more of the participation units in a private-issue closed-end FII. IMT is levied at a rate of 6.5 per cent on whichever is the higher of the property's value under the mandatory evaluation report prepared for the management company or the property's VPT, in proportion to the stake acquired. IMT is due by the purchaser.

19 Although allowed under Portuguese law, in practice the use of incorporated UCIs (either SICAVIs or SICAFIs) has been unsuccessful in the Portuguese market so far. Issues such as the potential application

Exempt income includes investment income (e.g., dividends), rental income derived from the lease of real estate, capital gains, and fees and commissions, unless the income derives from blacklisted jurisdictions.

Costs related to exempt income (including underlying taxes) are not tax deductible, including financial costs related to the acquisition of the assets or the costs relating to the taxes borne upon acquisition of the assets or during investment.

The standard 21 per cent CIT rate applies to the non-exempt taxable income obtained by FIIs, but income paid or due to FIIs is not subject to withholding tax. FIIs are exempt from state and municipal surtaxes.

***Stamp duty***

FIIs are liable for stamp duty, due each quarter, at a rate of 0.0125 per cent on the net global value of the fund. The net global value of the fund is given by the average of the values reported to the regulator by the management company on the last day of each quarter.

### v Tax regime for foreign investors

Income derived by non-resident investors from participation units in FIIs, whether upon distributions, redemption or transfer, is liable for income tax in Portugal at the rate of 10 per cent, with the following exceptions:

*a* for residents in blacklisted jurisdictions, dividends are taxed at 35 per cent and capital gains at 28 per cent (for individuals )or 25 per cent (for entities);

*b* income paid or made available in jumbo accounts[20] is taxed at 35 per cent; and

*c* non-resident entities with more than 25 per cent of their participation units or shares held by residents, except residents in the European Union, EEA Member States or in countries with a double tax treaty with Portugal providing for the exchange of information for tax purposes, are taxed at 25 per cent.

## IV REAL ESTATE INVESTMENT TRUSTS AND SIMILAR STRUCTURES

### i Legal framework

A legal structure similar to the real estate investment trusts (REITs) already available in other international markets was not available in Portuguese law until early 2019 and this was greatly anticipated by national and international investors. The Portuguese government enacted Decree Law No. 19/2019 of 28 January 2019 (Decree Law 19/2019), approving the legal framework for real estate investment and management companies (SIGIs).

However, the need to amend the initial version of this regime was recognised from the outset, and this was done with the enactment of Law No. 97/2019 of 4 September 2019 (Law 97/2019).

As well as introducing significant changes and clarifications to the SIGI legal and tax regimes, Law 97/2019 provided the legal certainty needed to overcome most of investors'

of withholding tax relief in cross-border distributions have therefore not yet been tested. For the sake of simplification, we refer in the text to UCIs of a contractual nature (FIIs), although the same rules apply to UCIs taking the form of a company.

20 Accounts opened in the name of one or more account holders acting on behalf of one or more unidentified third parties, in which the relevant beneficial owner of the income is not identified.

initial concerns. Unlike UCIs, SIGIs are not subject to specific regulatory supervision by the CMVM. However, once a SIGI becomes a listed company, it falls under the supervision of the CMVM and is subject to market transparency requirements.

### ii Requirements to access the regime

To acquire SIGI status, a company's corporate purpose must be the acquisition or holding of the following:

*a* real estate assets, or surface or equivalent rights over them, for leasing purposes, including agreements that include the services necessary for the use of the underlying real estate asset (e.g., when the real estate asset is used as a store or a space in a shopping centre, or as office space);[21]

*b* stakes in other SIGIs or in companies incorporated in the European Union or in the EEA with similar activities and features;

*c* stakes in UCIs with an income distribution policy identical to that of the SIGI; and

*d* stakes in real estate investment funds for residential letting or in companies for residential letting,[22] with an income distribution policy identical to that of the SIGI.

The SIGI must be incorporated as an SA, with a minimum subscribed and fully paid-up share capital of €5 million. SIGIs may be incorporated with or without a public subscription offer of shares, or through conversion from a previously existing public limited liability company or UCI into a SIGI.

All the SIGI's shares must be admitted to trading on a regulated market or multilateral trading facility in Portugal or any other country in the European Union or the EEA within one year.

From the third and fifth calendar years following admission to trading on a regulated securities market or multilateral trading facility (and not immediately after that admission, as was required under the initial regime), the SIGI's share capital must be diluted by up to 20 per cent and 25 per cent respectively, through a number of shareholders carrying a maximum of 2 per cent of voting rights.

As from the second year after incorporation, the SIGI must comply with the following requirements:

*a* the value of rights over real estate and admitted shares or participation units must represent at least 80 per cent of the total assets' value; and

*b* the value of rights over real estate subject to lease or other forms of commercial exploitation must represent 75 per cent of the total assets' value.

The SIGI must hold the assets for a minimum of three years. Within nine months of the end of each financial year, the SIGI must distribute as dividends at least:

*a* 90 per cent of profits resulting from dividends and distributions from shares or participation units; and

*b* 75 per cent of other remaining distributable profits.

21 SIGIs are allowed to develop construction and refurbishment projects on real estate assets available for lease.

22 FIIAHs and SIIAHs respectively.

Within three years of the sale of assets allocated to its main activity, the SIGI must reinvest at least 75 per cent of the corresponding net proceeds in other assets with the same purpose.

### iii Tax regime

Following the amendments made by Law 97/2019, Decree Law 19/2019 expressly determined that the SIGI and its shareholders are subject to the income tax regime for UCIs (see Section III.iv).

However, under a specific rule applicable to SIGIs, to qualify for the exemption on capital gains earned from the sale of real estate assets, the assets must have been held for lease purposes for a minimum of three years.

Although it was initially expected that SIGIs would also be liable for stamp duty on the net value of their assets under rules similar to those applicable to UCIs, Law 97/2019 does not specifically state that the UCI stamp duty taxation rule shall apply to SIGIs. It may be concluded therefore that SIGIs are not subject to stamp duty and, in our view, this position is supported by the fact that SIGIs do not assume the nature of UCIs and are not subject to the same legal regime.

## V INTERNATIONAL AND CROSS-BORDER TAX ASPECTS

### i Tax treaties

Portugal currently has a network of 79 double tax treaties, which generally follow the OECD Model Tax Convention.

Most of the double tax treaties concluded by Portugal already include a provision[23] granting to the state where the real estate is located (the source state) the right to tax capital gains derived by non-resident investors from the transfer of shares in companies whose value mainly derives from real estate located in the source state.

The number of double tax treaties including such a provision will increase as soon as the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) produces its effects over the double tax treaties signed by Portugal, although it is noteworthy that the treaties signed with Luxembourg and the Netherlands, both important investment centres, will be exceptions.[24]

Portugal was one of the 70 initial signatories of the MLI on 7 June 2017 and, following completion of the domestic approval procedures, Portugal deposited its MLI ratification instrument with the OECD on 28 February 2020, and the MLI will now come into force on 1 June 2020.

### ii Cross-border considerations

Under Portuguese law, there are in general no restrictions on the ownership of real estate and the acquisition of shares in Portuguese companies by non-residents or foreign investors.

23 Article 13 of the relevant treaty (capital gains).

24 The double tax treaties with Luxembourg and the Netherlands grant the residence state (i.e., Luxembourg and the Netherlands) exclusive taxation rights over the capital gains, and that will remain unchanged under the MLI.

However, non-resident investors may be required to comply with certain formalities, such as obtaining a Portuguese taxpayer number or appointing a local tax representative in the case of non-EU domiciled investors.

There are no foreign exchange controls in Portugal.

### iii Locally domiciled vehicles investing abroad

Apart from a number of other points of interest to foreign investors, from a tax perspective, the main advantages that make Portugal an attractive platform for real estate investments abroad are twofold:

*a* A full CIT exemption on dividends and capital gains on the disposal of shares is available for Portuguese resident companies under the participation exemption regime. The repatriation of profits out of Portuguese companies may also benefit from a withholding tax exemption.

*b* There is a CIT exemption for most of the income derived by Portuguese UCIs (either in the form of real estate investment funds or real estate investment companies) and REITs (SIGIs), and a 10 per cent tax rate on income obtained by non-resident investors in these vehicles.

## VI YEAR IN REVIEW

As expected, the Portuguese real estate market remained very active over the past year until the unexpected twist caused by the appearance of the covid-19 pandemic.

Regarding case law, we would highlight three decisions of the Centre for Administrative Arbitration (CAAD) issued during the third quarter of 2019 on the current personal income tax rules applicable to the taxation of non-residents' real estate capital gains. The decisions in these cases[25] unanimously confirmed once more that the current regime is discriminatory, breaching the freedom of movement of capital.

They follow several other CAAD decisions and the consistent case law of the Supreme Administrative Court on this matter, following decisions of the Court of Justice of the European Union in cases C-443/06 (Hollman), C-184/18 and C-440/08 (Gielen). Notwithstanding existing case law and the fact that the European Commission has sent a reasoned opinion urging the Portuguese government to amend this legislation within an infringement procedure, the Portuguese state continues to resist doing so. For the time being, non-resident individuals impacted by these rules will have to resort to courts to claim their rights.

As to new legislation in the sector, it is worth drawing attention to the amendment to the SIGI legal and tax regime, which had been awaited and was made mainly to tackle the 'original sin' of Decree Law 19/2019: as it was not supported by parliamentary legislative authorisation, the government had in Decree Law 19/2019 sought to apply to SIGIs the tax regime applicable to UCIs, solely on the basis of their qualification as REICs; this issue was addressed through a mere reference in the preamble.

In addition to introducing significant changes and clarifications to the SIGI legal and tax regimes, Law 97/2019 granted these regimes both greater political legitimacy through

25 Case Nos. 562/2018-T, 590/2018-T and 687/2018-T.

parliamentary approval and the legal certainty needed to overcome any concerns regarding the compatibility of the initial regime with the legislative power in tax matters, which is constitutionally attributed to the parliament.

Overall, and despite additional improvements that may still be introduced, the regime's new configuration is attractive enough for investors to use this vehicle, and this has been confirmed by the emergence of the first SIGI in Portugal.

Also, on 30 January 2020 the government presented in parliament Draft Law 11/XIV, transposing Directive (EU) 2018/822 of 25 May (DAC6), which introduces a set of rules on the automatic exchange of tax information for certain transactions and structures (known as 'mechanisms'). This regime will impact real estate investment structures and establishes a new obligation to report to the Portuguese tax authorities potentially aggressive tax planning arrangements, which are defined in broad terms and include arrangements that do not necessarily have a tax advantage as one of their main benefits.

According to DAC6, intermediaries established in the EU are obliged to report cross-border arrangements. However, Draft Law 11/XIV goes further and extends the reporting obligation to domestic mechanisms.

EU Member States should have transposed DAC6 into domestic law by 31 December 2019 and are obliged to apply the new rules from 1 July 2020. Consideration should also be given to the particularly demanding transitional regime for cross-border mechanisms already available, which requires that mechanisms whose first implementation step occurred or will occur in the period between 25 June 2018 and 30 June 2020 must be reported by 31 August 2020.

Therefore, it is expected that parliament will approve the Draft Law soon, although a delay in the entry into force of the new regime is possible given the context of the current pandemic.

## VII OUTLOOK

The coming year will be marked by the inexorable economic impact of the covid-19 pandemic – inevitably a severe economic downturn, but one whose full extent is still uncertain.

As in other sectors, real estate investors will have to adjust to the new conditions, with cash-flow needs being the most pressing issue in the short term. Debt restructuring and renegotiation of leases and other store utilisation contracts will increase and many investors will have to dispose of their assets, which will create opportunities for those with available cash.

As in recent years, investors are likely to continue to face significant adjustments regarding taxation arising from the international environment, in particular from the ongoing implementation of measures to counter aggressive international tax planning under the OECD and G20 Base Erosion and Profit Shifting Project.

The new rules on automatic exchange of tax information on cross-border and domestic investment structures arising from the transposition of DAC6 and the future effect of the MLI on the double tax treaties concluded by Portugal from 1 June onwards are clear examples of this trend. Sound investment structures will continue to be of the essence in dealing with the increasing potential for litigation with tax authorities in relation to cross-border transactions.

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**Chapter 9**

# SPAIN

*Meritxell Yus and Carolina Gómez*[1]

## I OVERVIEW

### i Investment vehicles in real estate

The main Spanish vehicles for investment in real estate properties are:

*a* general real estate companies;
*b* housing rental companies;
*c* real estate collective investment vehicles (RECIVs); and
*d* Spanish real investments trusts (SOCIMIs).

### ii Property taxes

The acquisition of real estate in Spain may be subject to value added tax (VAT) or transfer tax, depending on the transaction's legal and material features and on whether the seller is a VAT payer. When VAT applies, the purchaser has to pay stamp duty on the public deed documenting the transfer of the real estate.

The ownership and the disposal of a property in Spain triggers the following taxes in Spain depending on whether the owners are individuals or corporations, and on whether they are Spanish tax residents:

*a* Resident corporations: any income derived from the property (including capital gains arising from its disposal) is subject to corporate income tax.
*b* Resident individuals: any income derived from the property (including presumed income and any capital gains arising from its disposal) triggers personal income tax. The ownership of property in Spain may also be subject to wealth tax.
*c* Non-resident owners: any income derived from property located in Spain (including capital gains arising from its disposal) is subject to non-resident income tax. If the owners are individuals, this ownership could trigger wealth tax.

Additionally, the mere ownership of a property in Spain is subject to real estate tax (RET), a local tax payable annually by individuals and corporations owning real estate in Spain, whether resident in Spain or not.

The sale of the property is subject to a local tax on the increase in value of urban land, regardless of whether the owners are individuals or corporations and whether resident in Spain or not.

1 Meritxell Yus is a partner and Carolina Gómez is a senior associate at Cuatrecasas.

## II ASSET DEALS VERSUS SHARE DEALS

### i Introduction

Investments in real estate in Spain can be structured as asset deals (buying the real estate directly) or share deals (buying the real estate through the purchase of the corporate vehicle that owns it). Both structures are common and the choice is mainly based on the advantages and disadvantages of each option: the tax impact (considered on a case-by-case basis); the due diligence effort (more significant in the case of share deals); and the risk assumption, whereby the purchaser must assume risks related only to the property (asset deal), or related to both the property and the company (share deal).

### ii Corporate forms and corporate tax framework

***Limited companies***

When setting up a business in Spain, foreign investors generally incorporate or acquire a limited company. The two main types of limited companies in Spain are public limited companies (SAs) and private limited companies (SLs). Both have legal personality, separate and distinct from that of their owners, who are not personally liable for the company's debts.

The choice between an SA or an SL is mainly determined by the scale of the business, the legal requirements (only SAs can be listed), the future ability to raise capita, the rules on transferability that partners want to apply, and the flexibility offered by SL regulations compared to SA regulations. Traditionally, small and medium-sized companies have chosen the SL form because its characteristics are more suitable (lower capital requirements, statutory restrictions on the transfer of quotas are more stringent than for SAs, and there is more flexibility and greater autonomy in deciding on the company's structure and organisation). In contrast, SAs have traditionally met the needs of larger companies.

***Branch or representative office***

As an alternative, foreign companies can establish a branch or open a representative office. A branch is a secondary establishment operating permanently as a representative of its parent company. Although it has a degree of independence from its parent company and carries out all or part of that company's business activities, it does not have a separate legal personality. Representative offices mostly carry out ancillary, accessory and instrumental activities (including information gathering, market research and local support). Like branches, a representative office does not have a separate legal personality. This means that the parent company of a branch or a representative office will be liable for their obligations and debts.

***Other alternatives***

Another investment option is to associate through a joint venture with a business already established and functioning in Spain. Venture partners often create an equity joint venture by incorporating a limited company or acquiring a stake in an existing company. However, Spanish law contemplates other joint venture alternatives:

*a* temporary joint ventures, with no separate legal personality besides that of its members, created to carry out specific projects or services, such as an engineering or construction project;

*b* economic interest groups, which are frequently created to provide centralised services for a group of companies, and are aimed at facilitating, improving or increasing the economic activity of their members, who are held jointly and severally liable, albeit subsidiarily to the economic interest grouping; and

*c* joint accounts agreements, under which investors hold an interest in a business they do not manage by making contributions of money or in kind, which are not capital contributions, but give investors the right to participate in the positive or negative results of the business.

***Corporate tax framework***

Corporate income tax is levied on the worldwide income obtained by companies that are resident in Spain for tax purposes, regardless of the source or origin of that income. It is regulated under Act 27/2014 of 27 November.

*Tax base*

The tax base for corporate income tax is calculated on the declared accounting results (profit-and-loss account) and is subject to the adjustments required by Act 27/2014.

In general, accountancy expenses are considered tax deductible if they are duly registered in the company accounts and documented in a corresponding invoice.

Specific tax deduction rules apply to the following accountancy expenses: amortisation and depreciation of assets and rights, bad debts, and financial leasing agreements.

Under Act 27/2014, depreciation is allowed in respect of all tangible fixed assets (except land) and intangible fixed assets, based on their normal useful life. Different depreciation methods are available and depreciation rates are contained in official tables. In general terms, a maximum 2–3 per cent rate can be applied to buildings. Depreciation applies from the date the relevant asset is in working condition.

Net financial expenses are tax deductible up to €1 million per year. Net financial expenses exceeding this amount are tax deductible provided they do not exceed 30 per cent of annual earnings before interest, tax, depreciation and amortisation. A limitation additional to the general one described above applies to interest expenses derived from debt used to purchase shares in cases of tax consolidation groups or post-acquisition mergers under certain circumstances.

Tax deduction of impairment losses of the value of fixed tangible and intangible assets is applied to the tax year in which the asset is transferred to third parties or in the event of the winding up of the company.

Some expenses are considered non-deductible and must be adjusted to the tax base, including:

*a* remuneration on equity (dividends);

*b* corporate income tax duly paid;

*c* criminal or administrative fines and sanctions;

*d* gambling losses;

*e* donations, gifts and contributions to internal provisions or funds equivalent to pension schemes;

*f* expenses deriving from unlawful activities;

*g* expenses for operations performed, directly or indirectly, with individuals or entities residing in tax havens, except where the operation is proven;[2]
*h* financial expenses (interest) from debt-financing borrowed from a lender entity or entities that comprise a group of enterprises used to purchase shares in third entities or shares in other entities that belong to the same group of entities;
*i* remuneration exceeding €1 million per year paid to workers because of the extinction of the labour or commercial relationship with the enterprise;
*j* expenses incurred in transactions with related entities that, because of a different fiscal qualification of those entities, do not generate taxable income, or generate tax-exempt income or income subject to taxation below a 10 per cent tax rate;
*k* tax on stamp duty acts paid on signing a mortgage loan deed; and
*l* impairment losses in participations in quoted and unquoted entities.

*Reduction of the taxable base: capitalisation reserve*

Taxpayers subject to the standard rate are allowed to reduce their taxable base by 10 per cent of the increase in their equity, provided that this increase is maintained over a five-year period, and a separate reserve is recorded in an amount equal to the tax reduction, which must not be released over the five-year period. As a general rule, the increase in equity has to come from the undistributed income of the previous year. Therefore, shareholders' contributions or variations in respect of deferred assets should not be taken into account to determine the increase in equity. The capitalisation reserve is limited to 10 per cent of the positive income for that year. The limit is calculated on the taxpayer's taxable income without taking into account the adjustments for deferred tax assets or the offset of negative taxable bases.

*Offsetting negative tax base*

A negative tax base must be carried forward and offset against positive tax bases calculated in the following tax years without any temporary limitation.

The maximum percentage of income that can be offset by negative tax bases is 70 per cent of the positive tax base of a given year. The limit is calculated based on the taxpayer's taxable income before making adjustments to the capitalisation reserve.

However, companies may use €1 million of negative tax bases annually to offset their positive taxable income without regard to the 70 per cent limitation.

Specific limitations of 50 per cent and 25 per cent of the tax base before adjusting the capitalisation reserve and before offsetting apply when offsetting a negative tax base in the case of taxpayers whose turnover in the previous tax year exceeds €20 million.

2 Countries and territories that qualify as tax havens are listed on the tax haven blacklist approved by Spanish Royal Decree 1080/1991 but are automatically excluded from the blacklist when they sign a tax treaty with Spain containing an exchange-of-information clause or a tax exchange-of-information agreement. This exclusion is effective from the date the agreement or tax treaty enters into force.

The following are the general and specific limitations for offsetting.

| Maximum offsetting negative tax base calculated as a percentage of tax base prior to capitalisation reserve adjustment and prior to offsetting | |
|---|---|
| Turnover less than €20 million | 70% |
| Turnover between €20 million and €60 million | 50% |
| Turnover exceeding €60 million | 25% |

These limitations do not affect the right to offset €1 million of negative tax bases annually.

*Tax rates*

The current corporate income tax rate is fixed at 25 per cent.

A 15 per cent reduced tax rate is granted to newly created companies for the first tax period they have a positive tax base and for the following period.

*Tax credits*

A full tax exemption for double taxation is granted for dividends, profit distributions and capital gains deriving from the transfer of shares in other qualifying companies, whether resident or non-resident. For the company to qualify for the tax exemption, the taxpayer must hold a stake of at least 5 per cent in the company that is the subject of the share transfer, or the extent of the taxpayer's participation must be greater than €20 million, and the taxpayer must have had an interest in the company for at least one year before the date on which the dividends are payable or before the date of the transfer.

Special rules apply for this tax exemption when profit distributions or capital gains from the sale of participations derive from entities where income from dividends or capital gains from the sale of participations exceed 70 per cent of their total return.

Dividends from foreign sources and capital gains from transfers in qualifying foreign companies may also apply for this tax exemption provided that the requirements set out above are met. In addition, the profit distribution or the capital gain deriving from the transfer should correspond to a foreign entity subject to an income tax that is identical or analogous to Spanish corporate income tax and that tax rate should be at least 10 per cent. (this taxation requirement is deemed to be met if the foreign entity is resident in a country that has concluded a tax treaty with Spain that includes an exchange-of-information clause).

Losses derived from transfers in qualifying companies are non-tax deductible except when the company is liquidated.

A similar tax exemption is provided for foreign income derived from a permanent establishment (PE). Losses derived from foreign PEs are not tax deductible in the tax year in which losses are incurred but are deductible when the PE is liquidated.

Specific tax credits are granted for some corporate investments, such as research and development and technological innovation investments, and investments in film productions, audiovisual series and live performances of scenic arts and music.

Generally, foreign tax credit may be claimed for any foreign tax paid on foreign source income up to the amount of the tax payable in Spain on that income.

*Special corporate income tax regimes*

Corporate income tax regulations include several special tax regimes for some companies or activities, such as companies intended mainly to provide rental housing, Spanish real estate investment trusts (SOCIMI)[3] and foreign-securities holding companies (ETVEs) regimes.[4]

The special corporate income tax regime for companies intended exclusively to provide rental housing provides for an 85 per cent allowance on the tax due (an effective tax rate of 3.75 per cent) on the income (excluding capital gains) arising from the lease of dwellings, provided the following conditions are met:

*a* the taxpayer's main business activity must be the lease of dwellings located in Spanish territory;
*b* the lease must be for permanent dwellings (not short-term or seasonal leases);
*c* at least eight dwellings must be leased or offered for lease at any time of each tax period;
*d* dwellings must be leased or offered for lease for at least three years;
*e* each dwelling must be recorded separately for accounting purposes; and
*f* at least 55 per cent of the income obtained during the tax year must derive from dwellings or at least 55 per cent of the value of the company's assets must be able to produce qualifying income (i.e., income arising from the lease of dwellings).

Dividends corresponding with this income benefit from a 50 per cent corporate income tax exemption for double taxation. This special corporate income tax regime for companies has neither regulatory nor listing requirements.

Additionally, the corporate income tax regime provides for special tax deferrals for mergers, spin-offs, contributions of assets, exchanges of securities and the change of address of a European company or a European cooperative company from one EU Member State to another. This special regime is based on the tax deferral of the income obtained by all persons or entities affected in the corporate restructuring. The tax deferral regime will not apply if the transaction concerned is fraudulent or carried out with the intent to evade tax and, in particular, if the transaction concerned is not carried out for valid economic reasons but with the aim of obtaining a tax benefit.

### iii Direct investment in real estate

***Pre-existing tax liabilities***

In general terms, the purchaser of Spanish real estate assumes liability for outstanding payments in respect of the following taxes (up to the value of the real estate), regardless of who owned the property at the time the taxes became due for payment:

*a* certain local taxes levied on an annual basis, such as RET within the four-year statute of limitations period; and
*b* certain taxes levied on previous transfers or acquisitions (such as transfer tax, inheritance and gift tax, and non-resident income tax) within the four-year statute of limitations period, provided a tax lien is registered on the real estate in the property registry.[5]

3 Detailed information on SOCIMI is provided in Section IV.

4 Detailed information on ETVEs is provided in Section V.iii.

5 Although the general statute of limitations for taxes under Spanish law is four years, tax liens are in place for five years from registration. Therefore, the right to levy the tax would expire in four years unless this term was interrupted (in which case, the four-year period would start over). Tax liens expire after five years.

This liability is dependent on the prior declaration of default of the main debtor and of any jointly liable persons. Moreover, the new owner will only be liable in respect of the acquired real estate (up to its value) and not personally in respect of all of his or her assets.

Therefore, when acquiring a property, it is advisable to carry out a due diligence process to detect these potential liabilities.

Additionally, according to the Spanish General Tax Act,[6] a purchaser may be considered the successor of a seller if the acquisition of the assets (e.g., a property) allows the purchaser to continue with the seller's business activity. As the successor of the seller's business activity, the purchaser would be jointly and severally liable for any tax liability the seller incurs in connection with the business activity carried out.

This joint and several liability, in the case of the succession of the business activity, can be limited or even eliminated by requesting from the competent tax authorities a detailed certificate of debts, penalties and other tax liabilities deriving from the seller's business activity, in accordance with Section 175.2 of the Spanish General Tax Act. The purchaser must request the certificate, with the seller's consent, before completing the transaction.

Once the certificate has been requested, the purchaser's liability would be as follows:

*a* if the tax authorities does not issue the certificate within three months from its request, or if the certificate states that the seller does not have any debts, penalties or other pending tax liabilities, the purchaser would not be jointly and severally liable for any tax liability related to the seller's business; and

*b* if the certificate states that the seller has certain debts, penalties or other pending tax liabilities, the purchaser would be jointly and severally liable only for those stated in the certificate.

### ***Indirect taxation of the transfer of real estate in Spain***

The acquisition of real estate located in Spain may be subject to VAT or transfer tax, depending on the transaction's legal and material features, and on whether the seller is a VAT payer.

The main difference between these taxes is that, in certain circumstances, VAT is a neutral tax, whereas transfer tax is always a final tax. Depending on the purchaser's business activities, VAT paid on the acquisition of real estate may be recovered by offsetting it against VAT charged on other transactions or by directly claiming a refund from the tax authorities.

#### *VAT*

VAT is regulated under Act 37/1992 of 28 December (the VAT Act).

If the seller is a VAT taxpayer (company or individual) and the transaction is considered a business activity, the transfer will be subject to VAT (unless it involves an ongoing concern), although an exemption may apply in certain circumstances.

##### *Transfer of land*

The transfer of non-developed land or land not suitable for construction is exempt from VAT.

The transfer of developed land or land in the process of being developed for building purposes is not exempt from VAT (the VAT rate is 21 per cent).

6 Act 58/2003 of 17 December.

*Transfer of buildings*

The first transfer of buildings by the developer is not exempt from VAT.[7] The general VAT rate is 21 per cent; 10 per cent for dwellings.[8]

Subsequent transfers are exempt from VAT unless the purchaser intends to demolish or restore the buildings, provided certain requirements are met. If the purchaser intends to demolish the buildings, the transfer may be exempt, depending on the land's urban condition. The transfer is not exempt if the purchaser intends to restore the buildings, provided certain requirements are met. Under the VAT Act, works are considered restoration if:

*a* at least 50 per cent of the works are considered structural improvements (specific rules apply); and

*b* the total cost of the works qualifying as restoration exceeds 25 per cent of the acquisition price of the building (if the building was acquired in the previous two years) or, alternatively, 25 per cent of the building's current value at the beginning of the works (excluding the land in both cases).

Regarding the first requirement, the VAT Act specifies that the following will be considered structural improvements:

*a* consolidation works or works that modify the building's structure, facade or roofing;

*b* the following analogous works:
- structural conditioning work that enhances the building's safety, guaranteeing its stability and mechanical resistance;
- reinforcement or conditioning work on the foundations, as well as work affecting or involving the treatment of pillars or building frames;
- the extension of built surface area, above or below ground-floor level;
- reconstruction work on facades and courtyards; and
- the installation of elevators, including those for use by persons with disabilities that are designed to save architectural barriers; and

*c* the following works related to restoration (although the costs of these can only be taken into account if they are lower than the sum of categories a and b above):
- masonry, plumbing and woodwork;
- work carried out to improve and adapt enclosures, electrical installations, water, air conditioning and fire extinguisher systems; and
- energy renovation work, namely work carried out to improve the energy performance of buildings by reducing energy needs, increasing the performance of heating systems and installations, or installing equipment that uses renewable energy sources.

When a VAT exemption applies, the seller can waive the VAT exemption if the purchaser is entitled to deduct (in whole or in part) the VAT invoiced by the seller when transferring the real estate, depending on the purchaser's business.[9]

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7 If the developer has used or leased the property before the sale, the transfer is VAT-exempt in certain circumstances.

8 Four per cent for special protected housing, and for transfer of dwellings to housing renting companies that apply the especial corporate income tax regime.

9 Certain activities such as leasing dwellings are VAT-exempt and do not allow the input VAT to be deducted (the VAT pro rata rule).

VAT accrues at the time of transferring the real estate. Any VAT on advance payments will accrue at the time they are made.

As a general rule, the VAT payer is the seller, who issues an invoice plus VAT, and the purchaser has to pay the price plus VAT, recovering this by offsetting it against VAT charged in other transactions or by directly claiming a refund from the tax authorities. This mechanism has a financial effect as it may take a few months to recover the VAT.

In certain cases, the VAT reverse charge rule applies. This means that the seller does not have to invoice VAT; the purchaser includes the output VAT in its own VAT form, while deducting the same amount as input VAT, provided no pro rata rule applies. This mechanism means that VAT will not have any financial effect.

For transfers of real estate, the VAT reverse charge rule applies when the VAT exemption is waived; when there is a mortgage on the property at the time of the purchase (even if the seller redeems the mortgage at that time with part of the purchase price according to the Spanish tax authorities' criteria) or when there are urban liens registered and in force in the property registry;); or if the seller is in the process of bankruptcy.

Transfers of real estate subject to VAT and documented in a public deed will be levied with stamp duty as set out below.

*Transfer tax*

The Tax on Transfers and Stamp Duty Act is regulated under the Legislative Royal Decree 1/1993 of 24 September.

When VAT is not applicable (i.e., when the transfer of the real estate is not subject to VAT, or subject but exempt and the VAT exemption is not waived), the purchaser will pay transfer tax on the current value of the real estate.

The transfer tax is also levied on the acquisition of real estate property included in an ongoing concern sold by a VAT taxpayer as those transactions are not subject to VAT.

The general transfer tax rate is between 6 and 11 per cent; different rates and exemptions apply depending on the regions where the property is located and the property's features. There is no stamp duty if the transaction is subject to transfer tax.

*Stamp duty*

When VAT applies, the purchaser has to pay stamp duty on the public deed documenting the transfer of the real estate.

The stamp duty rate is between 0.5 and 3 per cent. Different rates and exemptions apply depending on the region where the property is located and the property's features. The stamp duty rate is often higher for transactions in which the seller has waived a VAT exemption.

***Tax on increase in value of urban land***

The seller of urban land (regardless of whether there are buildings on it) will have to pay a municipal tax for the increase of its cadastral value. The amount to pay is determined according to the cadastral value of the land and the number of years the seller has held the property. The applicable tax rate will depend on the municipality where the real estate is located. The Spanish courts have concluded that this tax does not have to be paid if no gain is obtained from the transfer under certain circumstances.

***Local taxes levied as a consequence of real estate ownership in Spain***

RET is levied annually on individuals and corporations that own real estate in Spain. The tax due is calculated based on the cadastral value of the real estate and the applicable tax rate, which depends on the municipality where the real estate is located.

Depending on the municipality and the specific circumstances, other local taxes may be payable (such as garbage collection tax, garage-entrance tax, etc.)

***Direct tax on holding real estate and disposal without a PE***

According to the Spanish Non-resident Income Act,[10] investment in real estate directly by a non-resident without a PE in Spain will be taxed in general:

*a* at a 19 per cent rate for EU, Norwegian and Icelandic tax residents on their net income – all rental expenditures are tax deductible, including interest; and

*b* at a 24 per cent rate in all other cases (on gross income obtained in Spain).

Where non-resident individuals hold property (excluding unbuilt land) without leasing it, the tax base would be a 'presumed income' calculated annually (regardless of whether the property is used) on either 2 per cent or 1.1 per cent of the cadastral value, depending on whether the cadastral value has been updated.

A special tax of 3 per cent of the real estate cadastral value will have to be paid annually by non-resident entities resident in tax havens with some exceptions.

Non-resident individuals are subject to the Spanish wealth tax on the net value of assets and rights that are located or can be exercised in Spain. This tax has a progressive rate ranging from 0.2 to 2.5 per cent although an exemption for the minimum of €700,000 for all taxpayers is applicable. Certain regions have approved particular rules for wealth tax purposes (rates or allowances), which could be more beneficial. Under the Spanish Wealth Tax Act,[11] EU tax residents are entitled to apply the wealth tax provisions established in the region where the assets or rights concerned are located or exercised, instead of the state legislation, which tends to be more burdensome. The Wealth Tax Act provides that real estate must be valued at the highest of the acquisition price, the cadastral value or any other value confirmed by the tax authorities relating to any other tax.

Capital gains from the transfer of real estate will be subject to the Spanish non-resident income tax at a 19 per cent rate. Certain allowances may be applicable (such as a 50 per cent exemption for capital gains from the transfer of urban properties acquired between 12 May and 31 December 2012, subject to certain requirements).

When a non-resident without a PE in Spain sells a real estate property, the purchaser has to withhold 3 per cent of the price to be paid on account of the seller's tax due for the capital gain. If that 3 per cent withholding is not made at the time of transfer, the payment or debt is transferred to the property and the purchaser therefore becomes liable for this tax (see Section II.iii, 'Pre-existing tax liabilities').

10 Legislative Royal Decree 5/2004 of 5 March.

11 Act 19/1991 of 6 June.

***Permanent establishment taxation***

Under the Spanish Non-resident Income Act, a non-resident is considered to act through a PE when he or she usually performs all or some of their business from any kind of facility or work place in Spain or acts in Spain through an agent authorised to contract on their behalf, provided that the agent habitually exercises these powers.

If a tax double tax treaty is applicable, it is necessary to abide by the PE definition in that treaty, which is usually more restrictive than the definition in the Spanish Non-resident Income Act.

In the case of real estate letting, the Spanish revenue authority considers that a non-resident acts through a PE in Spain when the letting activity could be considered an economic one under Spanish Personal Income Tax Act,[12] namely when at least one person is employed with a full-time employment contract.

Spanish PEs are subject to Spanish non-resident income tax on their worldwide income attributable at a general tax rate of 25 per cent. The tax base would be determined according to Spanish Corporate Income Tax Act, with certain particularities (such as rules limiting the deductibility of certain expenses).

### iv Acquisition of shares in a real estate company

***Pre-existing tax liabilities***

In a share deal, a company retains its pre-existing tax liabilities after its sale and therefore the purchaser acquires these liabilities. It is advisable to carry out a tax due diligence check to review the vehicle's tax position with respect to the main applicable taxes that are not statute barred, to identify and quantify the relevant tax risks, and to check whether the vehicle has fulfilled its tax obligations during the statute of limitations.

***Indirect tax on acquiring shares in a real estate company***

In general, the transfer of shares is not subject to indirect taxation, whether VAT or transfer tax.

However, under Article 314 of the Securities Markets Act (SMA),[13] a transfer of non-quoted shares in the secondary market that leads to the acquisition of or an increase in control over certain companies owning real property located in Spain may be subject to transfer tax or VAT where applicable if, by means of that transfer, taxation of the real estate transfer is evaded.

Unless proved otherwise, tax evasion is considered to exist in the following circumstances:

*a* the purchaser obtains control of the share capital of an entity where more than 50 per cent (at market value) of the total amount of the assets on its balance sheet consists of real property located in Spain not linked to a business activity;

*b* the purchaser acquires shares of an entity whose assets include securities that enable the acquirer to exercise control over another entity, more than 50 per cent (at market value) of whose assets consist of real property located in Spain not linked to a business activity; or

12 Act 35/2006 of 28 November.

13 Legislative Royal Decree 4/2015 of 23 October.

*c* the shares transferred were previously subscribed by the transferor in exchange for real estate not linked to a business activity transferred to the entity under incorporation or capital increase of the entity, and the time elapsed between the transfer and the previous acquisition is less than three years.

If taxation takes place within the scope of Article 314 of the SMA, transfer tax or VAT may be levied. The tax base will be the market value of the real property owned by the company whose assets are transferred, or the value of the real property owned by the subsidiaries in which a control position is reached by the purchaser, pro rata to the percentage of ownership.

***Direct tax on dividends and capital gains***

*Taxation of dividend distributions*

The taxation of dividends paid by a Spanish company to its shareholders is as follows.

*Spanish corporate shareholders*

There is a corporate income tax exemption for double taxation if:

*a* the Spanish corporate shareholder holds a participation of at least 5 per cent in the subsidiary company or the tax base (i.e., the acquisition value) in the participation is higher than €20 million; and

*b* the participation has been held uninterruptedly for at least 12 months at the time the dividends are due.

Corporate income tax is payable and there is a 19 per cent withholding tax rate if those requirements are not met. Requirement (b) could be met after the dividends are due, in which case, the dividends would be exempt from corporate income tax.

*Non-resident shareholders*

If the shareholder is a company resident in another EU or EEA Member State, dividends are exempt from non-resident income tax, provided that:

*a* the shareholder holds at least 5 per cent of the subsidiary company's share capital;

*b* both companies, the shareholder company and the subsidiary company, are subject to, and not exempt from, tax in their state of residence and have one of the legal forms referred to in the appendix to the EU Parent-Subsidiary Directive;

*c* the distribution of the profits by the subsidiary company does not derive from the liquidation of the company; and

*d* the EU parent company's participation in the subsidiary company has been held for at least one year at the time the dividend is due.

This tax exemption would be subject to the Spanish general anti-avoidance provisions.[14] Otherwise, dividends are subject to withholding tax in Spain at the general 19 per cent

14 Under the anti-abuse provision included by Spain on transposing the EU Parent-Subsidiary Directive into Spanish domestic law, this exemption would not be applicable if a majority of the voting rights in the parent company is held, directly or indirectly, by non-EU entities or individuals under certain circumstances.

tax rate unless the shareholder is entitled to apply a double tax treaty (in which case the applicable withholding tax would be the lower of the reduced tax rate established in the tax treaty and the ordinary domestic withholding tax rate of 19 per cent).

*Taxation of potential divestment*

Any income derived by shareholders as a result of the transfer of shares in a Spanish subsidiary company – or its liquidation – would be taxable in Spain as follows.

*Spanish corporate shareholders*

There is a corporate income tax exemption for double taxation if:

*a* the shareholder holds a participation of at least 5 per cent in the project company or the tax base (i.e., the acquisition value) in the participation is higher than €20 million; and

*b* the shareholding has been held uninterruptedly for at least 12 months at the time the transfer is carried out.

If these requirements are not met, there is no exemption from corporate income tax. The exemption is neither totally nor partially applicable in other specific cases, such as passive or holding companies.

*Non-resident shareholders*

The proceeds from divestment would be subject to non-resident income tax at the 19 per cent tax rate under the Non-resident Income Tax Act, as long as the relevant subsidiary company qualifies as a real estate company, unless the shareholder is entitled to apply a double tax treaty[15] under which Spain is not entitled to tax this capital gain.

***Real estate companies held by non-resident individuals: wealth tax***

As a rule, non-resident individuals are subject to wealth tax on direct (not indirect) shareholdings in a Spanish company unless an applicable tax treaty prevents Spain from taxing this event.

Although the Spanish Wealth Tax Act provides that only a direct holding in a Spanish company is subject to this tax, the Spanish tax authority has concluded in several tax rulings[16] that the indirect holding by a non-resident individual of company shares is taxable in Spain if the company's main assets consist of real estate located in Spain.

The Spanish Wealth Tax Act provides that shares in companies must be valued depending on whether the companies have been audited. If they have been audited, they are valued at book value (i.e., the net equity value) of the most recently approved financial statements. If they have been not audited or the audit was not favourable, shares in companies

15 The current wording of the provisions related to capital gains derived from the disposal of a real estate company set out in many tax treaties signed by Spain is expected to be modified by the Organisation for Economic Co-operation and Development Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Sharing by introducing an anti-avoidance provision that establishes a 365-day period preceding the disposal for testing if the company's shares do not derive more than 50 per cent of their value from immovable property to prevent the avoidance of capital gains tax.

16 However, in November 2019 ,the Spanish tax authority issued a tax ruling under the terms of the Spanish Wealth Tax Act (namely that only the direct holding of a Spanish company is taxed in Spain), which implies a change in the authority's criteria.

are valued at the highest of the three following values: nominal value, book value of the most recently approved financial statements, or capitalisation at a 20 per cent rate of the profits obtained during the three financial years completed before 31 December of the calendar year in question.

However, the Wealth Tax Act sets out an exemption for shareholders who hold a stake in family-owned companies, subject to certain requirements. Moreover, it provides a general minimum €700,000 exemption for all taxpayers. As mentioned above, certain regions have approved specific rules for wealth tax purposes (e.g., rates and allowances) that could be more beneficial and applicable to EU tax residents.

## III REGULATED REAL ESTATE INVESTMENT VEHICLES

### i Regulatory framework

In Spain, there are two types of real estate collective investment vehicles (RECIVs): real estate investment funds (REIF), and real estate investment companies (REIC).[17]

RECIVs are regulated under Act 35/2003 of 4 November on Collective Investment Institutions, the regulations of which are contained in Royal Decree 1082/2012 of 13 July.

RECIVs are financial instruments allowing small investors to channel their investments in real estate.

### ii Overview of the different regulated investment vehicles

The establishment of RECIVs is subject to the prior authorisation of the Spanish Securities Market Commission (CNMV).

RECIVs must invest in urban real estate for rental purposes and cannot sell their assets until three years have elapsed since their acquisition. A RECIV can also invest up to 15 per cent of their total assets in certain entities (such as SOCIMIS, other RECIVs or real estate limited companies) under certain conditions.

RECIVs can use up to 20 per cent of their total assets to develop new real estate to be used for rental purposes. The minimum holding term of these new properties is seven years after the completion of building works.

No asset (including the rights over it) may represent more than 35 per cent of the total net assets.

RECIVs cannot sell assets to the companies of their own group. Certain limits apply to the acquisition and rental of real estate assets from other companies of the group.

At least 70 per cent (in the case of REIF) or 80 per cent (in the case of REIC) of the annual average of the monthly balance must be invested in urban real estate assets for rental purposes, which may be acquired at different stages of construction.

RECIVs' investments must comply with certain principles of liquidity. The minimum share capital or net assets of RECIVs is €9 million, contributed in cash or in real estate assets. As a rule, RECIVs must have at least 100 shareholders.

17 Spanish REITS (SOCIMIs) are discussed in Section IV.

### iii Tax payable on acquisition of real estate assets

The indirect taxation of the acquisition of real estate assets by a RECIV is not subject to any specific provisions except for the following tax incentives:

*a* a tax exemption may apply for the incorporation of RECIVs, capital increases or non-monetary contributions; and

*b* a tax benefit of 95 per cent may apply to the transfer tax due on the acquisition of urban real estate used for rental housing and for the acquisition of land to develop the real estate to be used for rental purposes, subject in both cases to fulfilling the three-year holding period for these assets.

### iv Tax regime for the investment vehicle

To prevent double taxation on income derived from the underlying investments, the Corporate Income Tax Act provides for a special tax system based on applying a reduced 1 per cent rate to RECIVs that fulfil certain requirements. If the real estate assets are transferred before the minimum holding term, they must regularise the corporate income tax paid based on the general applicable rate.

### v Tax regime for investors

RECIVs do not usually pay dividends. If distributed, dividends are taxed at the investor level, depending on their circumstances, at their personal income tax rate, without the right to claim for the exemption for double taxation.

Capital gains obtained by corporate income taxpayers or non-residents with a PE will be taxed at the applicable tax rate for corporate income tax or non-resident income tax for the recipient. The exemption for double taxation of capital gains included in the Corporate Income Tax Act cannot be claimed.

Capital gains obtained by personal income taxpayers resident in Spain will be included in the tax base and will be subject to taxation at the applicable rate. Under certain circumstances, the deferral regime is applicable in the case of the reinvestment of participations in REIFs.

Capital gains obtained by non-resident shareholders without a PE in Spain will be taxed at the applicable non-resident income tax rate. Under certain tax treaties, the capital gain will not be taxed in Spain.

## IV REAL ESTATE INVESTMENT TRUSTS AND SIMILAR STRUCTURES

### i Legal framework

SOCIMIs, inspired by REITs, are regulated under Act 11/2009 of 26 October.

### ii Requirements to access the regime

***Corporate requirements***

A SOCIMI must be incorporated as a public limited company (SA). Its corporate name must evidence its status as a listed real estate investment company or include the abbreviation SOCIMI, SA.

The SOCIMI's main corporate purpose must be one of the following:

*a* the acquisition and development of urban real estate for rental purposes, including restored buildings under the terms provided in the VAT Act;

*b* the holding of shares in SOCIMIs or other non-resident companies in Spain, when they have the same corporate purpose as the SOCIMI and are subject, by law or under the company's by-laws, to a regime similar to that applicable to SOCIMIs regarding the obligatory distribution of profits;

*c* the holding of registered (and not bearer) shares in other entities, whether resident or non-resident, with a main corporate purpose of acquiring urban real estate for rental purposes and a regime, by law or under the company's by-laws, similar to that established for SOCIMIs regarding the obligatory distribution of profits and investment of income and assets, subject to the requirement that share capital must belong to SOCIMIs or any of the companies mentioned in (b) above, which cannot have any subsidiaries or investee companies; and

*d* the holding of shares or units of RECIVs.

In addition to its main corporate purpose, a SOCIMI can pursue different supplementary business activities. The combined revenues from other supplementary business activities must account for less than 20 per cent of the company's total revenues for each tax period.

A SOCIMI's share capital must be at least €5 million, represented by one class of registered shares. Contributions of real estate assets to the SOCIMI, at incorporation or in a capital increase, must be accompanied by a report from an independent expert appointed by the commercial registry.

SOCIMIs must distribute their annual profit to their shareholders. Profit distribution must be approved within six months following the end of each year, and must include the allocation of:

*a* 100 per cent of profit from dividends or any other profit sharing distributed by the investee companies of the SOCIMI in development of its main corporate purpose;

*b* at least 50 per cent of profits from the transfer of real estate and shares or equity holdings dedicated to the development of the SOCIMI's main corporate purpose, as long as the transfer is made after the minimum holding term has expired. The remaining profits must be reinvested in other real estate or equity holdings dedicated to activities comprising the main corporate purpose, within three years following the transfer that generated the capital gain giving rise to the income. If it is not reinvested, it must be distributed in full in the year the term for reinvestment expires. If real estate or shares and equity holdings involved in the reinvestment are transferred before the minimum holding term expires, the income gained from that transfer must be distributed in full in the year the transfer was made; or

*c* at least 80 per cent of all other profits obtained, which includes income from revenues obtained on the properties leased by the SOCIMI or from other activities.

The dividend must be paid during the month following the date on which the resolution for distribution is approved.

Act 11/2009 states specific features regarding the content of the SOCIMI's annual accounts.

For the special tax regime to apply, the SOCIMI's shares must be admitted to trading on:

*a* a regulated market in Spain, or in a Member State of the EU or the EEA or in a state that has an effective exchange of information with Spain; or

*b* a multilateral trading facility in Spain, or in a Member State of the EU or the EEA.

SOCIMIs are subject to requirements concerning how they invest their assets and attain revenues from operating their business.

At least 80 per cent of the value of a SOCIMI's assets must be assigned to:

*a* acquire and develop (including restore) urban real estate for rental purposes;

*b* acquire land to develop real estate assets that will be used for rent, as long as the development begins within three years from its acquisition; or

*c* equity holdings in qualifying entities for the development of the SOCIMI's main corporate purpose.

The value of the SOCIMI's assets is determined as the average of the individual balance sheet of the companies, or based on the consolidated quarterly balance sheet for the year if the SOCIMI is the parent company of a group of companies.

If the SOCIMI (or its investee companies) owns real estate abroad, it must have a similar nature to the real estate in Spain to qualify as real estate properties for this purpose. Also, the country where it is located must have an effective exchange of tax information with Spain.

In addition, at least 80 per cent of revenues for the tax period must be obtained from one or both of the following:

*a* the rental of real estate assets under the SOCIMI's main corporate purpose to non-related persons or entities; and

*b* dividends or profit sharing from equity holdings in entities that can be considered suitable to develop the SOCIMI's main corporate purpose.

To calculate the previous 80 per cent requirement, revenues obtained from the transfer of equity holdings or real estate used to develop the SOCIMI's main corporate purpose will not be considered revenue for the tax period if the three-year minimum holding period has expired.

The 80 per cent must be calculated considering consolidated income if the SOCIMI is the parent company of a corporate group and regardless of the relevant entities' place of domicile and whether they are obliged to draft consolidated annual accounts.

Real estate comprising the SOCIMI's assets must be leased for at least three years. This term includes the time during which the properties have been offered for rental, up to one year. The three-year term is calculated as follows:

*a* if the real estate was part of the SOCIMI's corporate assets before applying the special tax regime, the term is calculated from the starting date of the first tax period that the special tax regime was applied, when the property was already rented or offered for rental from that date; or

*b* if the real estate was developed or acquired later (or not rented when the special tax regime was first applied), from the date it was first rented or offered for rental.

Shares or equity holdings in the share capital of investee companies developing the SOCIMI's main corporate purpose must be held as part of the companies' assets for at least three years from their acquisition or from the starting date of the first tax period in which this special tax regime was applied.

Failure to observe the minimum holding period will not result automatically in loss of the special tax regime. However, the SOCIMI will be taxed on all revenues generated by the assets during the tax periods the special tax regime would have applied, including rental revenues and revenues from transfers, under the general tax regime and at the general tax rate.

### iii Tax regime

SOCIMIs that fulfil the corporate requirements can choose to apply a special tax regime, which provides for a neutrality system for SOCIMIs (subject to a zero per cent corporate income tax rate) and for the effective taxation of its shareholders in their respective personal income tax.

The special tax regime can be applied to the SOCIMI and, if specific requirements are fulfilled, to entities in which the SOCIMI holds a stake in the development of its main corporate purpose, namely a stake in resident entities whose main activity is to acquire urban real estate for rental activities; that are subject to the same mandatory policy, whether legal or statutory, of profit distribution; and that meet the SOCIMI's investment requirements.

The general meeting of shareholders must approve the decision to apply the special tax regime. That choice has to be notified to the Spanish Delegation of the State Agency for Tax Administration (AEAT). The special tax regime will apply for the tax period ending after notice is given and for following tax periods, and it will cease to apply from the year it is waived or when entitlement to its application is lost.

A SOCIMI can access the special tax regime even if at the time of that option, some requirements, considered non-essential, are not fulfilled (such as those concerning investment of assets, source of revenues, obligation to have shares traded on regulated markets, minimum share capital and corporate name). In any event, those requirements must be fulfilled within two years from the date the application of the special tax regime was approved.

#### *Features relating to corporate income tax*

The corporate income tax rate for SOCIMIs is zero per cent.

If the zero per cent tax rate applies, the SOCIMI cannot set off negative tax bases or claim tax deductions or subsidies on tax payable.

SOCIMIs are obliged to make withholdings on account of dividends and income distributed to their shareholders, unless the shareholders are entities entitled to apply the SOCIMI regime.

SOCIMIs must regularise income taxed under the special tax regime (regularisation involves taxation under the general regime and at the general corporate income tax rate for that income) in the following circumstances:

*a* the minimum three-year period for holding real estate is not observed, with the result that all the revenues obtained from these properties in all the tax periods the special tax regime was applied must be regularised;

*b* the minimum three-year period for holding shares or equity holdings is not observed, with the result that the portion of revenues generated by the transfer of shares or equity holdings must be regularised; and

*c* the SOCIMI is taxed for corporate income tax under a regime other than the special tax regime for SOCIMIs before the three-year term expires.

***Special tax applicable to SOCIMIs***

SOCIMIs may be subject to an additional special corporate tax in Spain. This taxation may arise when the SOCIMI's governing body resolves to distribute profits obtained by shareholders that are not subject to income tax on these profits or are subject to a lower tax rate on these profit distributions.

This additional special corporate tax is part of the corporate income tax payable and it will be 19 per cent calculated on the gross amount of the dividends or profit sharing distributed to shareholders whose stake in the company's share capital is 5 per cent or more, and whose personal income tax due on these dividends or profit distributions is null or lower than 10 per cent.

In the case of shareholders that are not resident in Spain for tax purposes, the tax rate to which the profits distributed by the SOCIMI are subject will be determined based on the withholding rate at source (if any) applicable to these dividends when they are distributed in Spain. It must also consider the tax rate to which non-resident shareholders are subject in their country of domicile, minus any deductions or exemptions for avoidance of international double taxation that apply as a result of the payment of those profits. Therefore, if the withholding rate at source is 10 per cent or higher, the minimum taxation requirement will be considered fulfilled and the special tax will not apply, regardless of whether a deduction or exemption for avoidance of international double taxation is subsequently applied to the dividend for the payee's benefit under applicable law.

This special tax will not apply if the shareholder receiving the dividend is an entity qualifying to apply the SOCIMI regime or a non-resident entity, provided that the dividends received are taxed at a rate of at least 10 per cent.

In connection with that additional special corporate tax, a SOCIMI's shareholders are subject to certain reporting obligations. Those with a stake of at least 5 per cent of share capital must substantiate to the SOCIMI that they are subject to income tax at a rate of at least 10 per cent. They must make that disclosure within 10 days from the date the dividend is paid. Otherwise, that income will be considered exempt or taxed at a lower rate, and the SOCIMI will liable for the additional special corporate tax.

The SOCIMI must ensure shareholders' performance of those reporting obligations so it can foresee any circumstances of application of the additional special corporate tax.

***Opting for the special tax regime: loss of eligibility***

Companies that access the special tax regime for SOCIMIs after being taxed under a different regime will be subject to the following special rules:

*a* Any tax adjustments pending reversal in the tax base at the time of application of the special regime will be included in keeping with the general regime and at the general corporate income tax rate.

*b* Any negative tax bases pending set-off at the time of application of the special regime will be set off against any positive income taxed under the general regime.

*c* Revenues from the transfer of real estate owned before applying the special regime and obtained while the special tax regime applies will be held to have been generated linearly over the term of ownership of the transferred property, unless proof to the contrary is delivered. The portion of revenue attributable to tax periods preceding the application of the special regime will be taxed at the general tax rate and under the tax regime in place before the application of the special tax regime. The same rule applies to revenue from the transfer of equity holdings in other companies dedicated to the main corporate purpose and to all other assets.

*d* Deductions from the amount of tax payable pending application will be deducted from the amount of tax payable under the general regime.

If the company is taxed under the special regime for SOCIMIs and then under a different regime, there is a special rule to determine the revenue from the transfer of real estate owned at the beginning of the tax period in which the company abandons the special regime that was generated in periods in which the tax regime other than the special regime applies. In these cases, that revenue will be considered to have been generated linearly over the term of ownership of the transferred property, unless there is proof to the contrary. Therefore, the portion of that revenue attributable to tax periods during which the special regime applied will be taxed in accordance with the conditions for the special regime. That same rule applies to revenue from the transfer of equity holdings in other companies dedicated to the main corporate purpose.

***Tax payable on acquisition of real estate assets***

The indirect taxation of the acquisition of a real estate asset by a SOCIMI is not subject to any special rules, except for the following tax incentives:

*a* a tax exemption may apply to the incorporation of the SOCIMI, and to capital increases or non-monetary contributions to SOCIMIs; and

*b* a tax benefit of 95 per cent may apply to the transfer tax due on the acquisitions of urban real estate used for rental housing and for the acquisitions of land to develop the real estate to be used for rentals, subject in both cases to fulfilling the three-year holding period for these assets.

### iv Tax regime for investors

If the dividend derived from the years the special tax regime is applied, is paid to a taxable person for corporate income tax or to a taxpayer of non-resident income tax with a PE, it will be taxed at the rate applicable for corporate income tax or non-resident income tax with a PE (currently 25 per cent). In both cases, the exemption for double taxation of dividends cannot be claimed.

If the dividend or profit sharing is paid to a personal income tax payer, it will be taxed in the taxable savings base.

If the dividend or profit sharing is paid to a non-resident income tax payer without a PE in Spain, it will be subject to non-resident income tax at the general 19 per cent rate unless a tax treaty is applicable. The doctrine of the Spanish General Directorate for Taxation is favourable to these dividends or profit distributions benefiting from the tax exemption under the Parent-Subsidiary Directive when the beneficiary is a tax resident in the EU. However, this favourable administrative approach must be weighed against the judgment of the Court of Justice of the European Union (CJEU) in Belgium v. Wereldhave Belgium and others,[18]

18 Judgment of 8 March 2017 in Case C-448/15.

where the Court stated that the Parent-Subsidiary Directive tax benefits cannot be applied if the EU parent company receiving the dividend is an investment entity subject to a zero tax rate subject to the condition of full profit distribution to its shareholders.

If the revenue obtained from transferring or redeeming the SOCIMI's share capital is paid to corporate income taxpayers or non-residents with a PE, it will be taxed at the applicable tax rate for corporate income tax or non-resident income tax for the recipient (currently 25 per cent). The exemption for double taxation of capital gains provided under Corporate Income Tax Act cannot be claimed.

If the revenue is obtained by personal income taxpayers and represents a capital gain or loss, it will be included in the taxable savings base.

Finally, if the revenue is paid to a non-resident without a PE in Spain holding 5 per cent or more of the SOCIMI, that revenue will be subject to taxation at the standard tax rate (currently 19 per cent) unless a tax treaty is applicable. If it is paid to a non-resident without a PE in Spain holding less than 5 per cent of the SOCIMI, it may be exempt from Spanish non-resident income tax provided that certain requirements are met (such as a tax treaty with an exchange of information clause).

### v Forfeiture of SOCIMI status

Entitlement to apply the special tax regime will be lost and the general tax regime will apply for tax periods in which any of the following circumstances arise:

*a* delisting from regulated markets or from a multilateral trading facility;

*b* a substantial breach of the reporting obligations to be included in the SOCIMI's annual accounts, unless the breach is remedied in the notes to the annual accounts of the following year;

*c* the failure to pass a resolution for distribution, or partial or total payment of dividends in the terms and by the deadlines established in Act 11/2009 and taxation under the general regime will occur for the tax period corresponding to the year in which the income gave rise to those dividends;

*d* the waiver of application of the special tax regime; and

*e* the breach of any other requirement established under Act 11/2009 for the entity to apply the special tax regime, unless the cause of the breach is remedied within the following year, with the exception that the breach of the holding period for assets, whether real estate or equity holdings, will not result in the loss of the special tax regime.

If the company loses entitlement to apply the special tax regime, no matter the cause, it will not be eligible to apply it again until three years have passed from the end of the last tax period during which the special tax regime could be applied.

## V INTERNATIONAL AND CROSS-BORDER TAX ASPECTS

### i Tax treaties

Spain has entered into more than 94 double tax treaties with countries worldwide (particularly relevant is its treaty network with South American countries), many of which are based on the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and on Capital, and it is continually expanding its treaty network.

As a rule, most of the tax treaties Spain has signed set out a special provision (a real estate clause) under which tax is chargeable in Spain on capital gains arising from the transfer of shares of companies whose main assets comprise, directly or indirectly, real estate located in Spain. It is expected that the renegotiation of tax treaties that do not include this real estate clause, such as that between the Netherlands and Spain, will result in its inclusion.

According to its provisional position, Spain has adopted an ambitious role in the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Sharing (MLI). Spain has chosen to amend most of the tax treaties or covered tax agreements (CTAs) in force, in accordance with the MLI.

Article 9, Paragraph 1 of the MLI includes a special real estate clause under which the source state is entitled to tax this capital gain if, at any time during the 365 days before the transfer, a certain threshold is exceeded. Paragraph 4 of Article 9 specifies this threshold as the traditional 50 per cent rate.

In particular, Spain has not reserved the right for the entirety of Article 9, Paragraph 1 not to apply to its CTAs; in other words, Spain has chosen to apply this provision. Furthermore, Spain has chosen to include the provision of Article 9, Paragraph 4.

In any case, Spain has yet to finish internal ratification of the MLI, which was stalled on account of the recent elections. Once the internal ratification process is complete, Spain will need to deposit its instrument of ratification to bring the MLI into force for its CTAs.

### ii Cross-border considerations

Foreign investment in Spain, including real estate investment and ownership, is not generally restricted (except for specific sectors such as activities related to national defence).

However, investors must comply with Spanish anti-money laundering (AML) regulations, which include providing information about the beneficial owner (the real beneficiary of the investment) and the origin of the investor's funds.

Spain has implemented the EU directives on the prevention of the use of the financial system for the purposes of AML and terrorist financing. EU and Spanish AML regulations are in line with the Financial Action Task Force Recommendations. AML rules apply to several obliged entities, including banks and other financial and credit institutions, real estate agents and brokers, auditors, external accountants and tax advisers, notaries and lawyers. These entities should (1) implement an internal control system that includes a policy and procedures to identify their clients (know-your-client (KYC) policy), and (2) identify (and avoid) suspicious activities and transactions, and report them to the authorities (namely the Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offences, or Sepblac). Obliged entities must also gather and store their clients' information, and keep it available for Sepblac.

A real estate transaction usually involves several obliged entities (e.g., a bank, a real estate agent, a lawyer and a notary), and each entity must apply its KYC and AML risk assessment policy independently. The parties must provide the required information to all involved obliged entities separately, and the transaction schedule has to take into account the time, information and documents these entities need to conduct their KYC and AML procedures.

Moreover, some foreign real estate investments have to be notified to the Secretary of State for Trade or the Bank of Spain, or both of these. These reporting obligations are imposed for statistical and tax purposes, and to prevent infringements of the law. Failure to comply with these reporting obligations may result in monetary fines.

### iii Locally domiciled vehicles investing abroad

Corporate income tax regulations include a special ETVE regime. This regime is granted to companies meeting specific requirements and includes the following features:

*a* the qualifying holding company can claim exemptions to avoid international double taxation of dividends and income from foreign sources resulting from the transfer of equity shares in non-resident companies if the following conditions are met:
- the holding company holds a stake of at least 5 per cent in the non-resident company or the participation cost is higher than €20 million;
- the holding company has held the interest for at least one year before the date on which the dividends are payable or before the date of the transfer; and
- the profit distribution or the capital gain deriving from the transfer corresponds to a foreign entity subject to an income tax that is identical or analogous to the Spanish corporate income tax, and that tax rate is at least 10 per cent; and

*b* dividends and capital gains obtained by foreign shareholders (not resident in tax havens) are not taxable in Spain as they arise from exempt income derived from foreign subsidiaries.

## VI YEAR IN REVIEW

During the past few years, no significant changes or developments in domestic law or the tax criteria of the Spanish tax authorities have been approved.

Notably, a protocol amending the double tax treaty between Spain and the United States entered into force on 27 November 2019 and introduced significant changes by reducing (or even providing exemption from) taxation at source, following the line of tax treaties between the United States and other EU Member States.

## VII OUTLOOK

Of note are the judgments of the CJEU of 26 February 2019, commonly referred to as 'the Danish cases', on the interpretation of the EU Parent-Subsidiary Directive and the EU Interest and Royalties Directive, and their connection with concepts such as beneficial ownership, tax avoidance and tax abuse. These landmark CJEU decisions will have an important effect on the application of the withholding tax exemptions for dividends and interest paid to EU recipients. The Spanish Central Economic-Administrative Court subsequently applied the jurisprudence from the Danish cases in its decision of 8 October 2019. It is advisable to remain attentive to the approach adopted by the Spanish tax authorities and, particularly, the Spanish courts regarding this issue in the coming months.

Spain has not yet implemented in its domestic tax legislation all the tax measures included in the EU Anti-Tax Avoidance Directive (ATAD). Although Spain has already introduced some ATAD measures, modifications concerning controlled foreign company rules, exit tax and earnings-stripping rules are still required. All these tax measures may affect multinational groups' structures and cross-border transactions with Spain.

**Appendix 1**

# ABOUT THE AUTHORS

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Meritxell Yus is head of Cuatrecasas' indirect taxation practice, comprising lawyers who specialise in indirect taxes, including VAT, transfer tax and stamp duty, and customs and excise duties. They also advise on local taxes and specific regulated-sector taxes.

She has extensive experience in advising multinational groups and has in-depth knowledge of indirect taxation, particularly VAT applicable to international transactions, and sectors and businesses that are VAT-exempt.

A member of the firm's real estate and construction group, she specialises in real estate taxation, advising on and planning real estate transactions in the private and public sectors, and restructuring real estate groups. An expert in designing real estate investment and disinvestment structures, she has extensive knowledge of state, regional and local taxation of these kinds of transactions.

Given her tax expertise in this area, Ms Yus has participated in many corporate and business M&A transactions.

She is recognised by several legal directories, including *Best Lawyers* in the tax category and *International Tax Review*'s Special Focus publication *Women in Tax Leaders* in the field of indirect tax.

Ms Yus lectures on indirect taxation and coordinates this area of the master's programme in legal and tax planning and consultancy at the International University of Catalonia, she is a member of the Urban Land Institute and is a partner at VAT Forum.

## CAROLINA GÓMEZ

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Carolina Gómez specialises in advising Spanish family businesses, and national and international foreign international groups, particularly on planning real estate acquisitions in Spain, restructuring real estate groups and financing transactions on tax matters. Her practice also includes dealing with Spanish tax audit procedures.

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Ms Gómez has actively participated in several real estate acquisition and restructuring transactions.

She lectures in the master's programme in legal and tax planning and consultancy at the International University of Catalonia and she is a member of the Urban Land Institute.

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