Over the last few years, the Spanish real estate market has been very dynamic because, among other reasons, foreign investors have made important investments in the acquisition of real estate in Spain, both in housing and commercial premises. Analysts consider that this level of investment will continue over the next few years.

Detailed below are the main issues from a Spanish tax point of view that non-residents, both private individuals and companies, should bear in mind when investing in Spanish real estate.

Spanish Taxation

Real estate in Spain is subject to both direct taxation, in the form of tax on profits earned, as well as indirect taxation, levied on the operations carried out thereupon.

According to Spanish tax laws, there are two kinds of taxpayers:

- Spanish residents (companies or individuals) subject to taxation in Spain on their worldwide income. This means, for example, that if a US citizen becomes a Spanish resident, then he/she will be obliged to pay tax in Spain on his/her worldwide income, regardless of (i) the type of income or (ii) where the income was generated. There is, however, an exception in that, since 1 January 2004, employees transferred to work in Spain can now opt to pay tax in Spain as non-residents for the first five years, so long as they have not been resident in Spain during the ten years prior to their transfer and such transfer derives from an employment contract.

- Non-residents subject to taxation in Spain only on income obtained in Spain.

Taxation of Real Estate Located in Spain Owned by Non-Resident Companies or Individuals

Below is a summary of the various taxes that are currently in effect and that are applicable to non-residents, either private individuals or companies, that own real estate in Spain.

Corporate Income Tax. Non-resident companies, without a permanent establishment in Spain, will be taxed at the fixed rate of 25% for revenues earned by renting rural or urban real estate located in Spain.

In general, capital gains arising from the transfer of real estate are taxed at the rate of 35%. Certain updating coefficients are applied to the acquisition value depending on the number of years that have elapsed. Should the owner of the real estate in Spain be a State, tax payment exemption may be requested in Spain from the Spanish Ministry of Foreign Affairs.

Usually, the double taxation treaties signed by Spain allow the Spanish authorities to tax in Spain both the capital gains and the income obtained by non-residents from the sale/use of real estate located in Spain.

Resident as well as non-resident entities that own real estate in Spain will not be subject to net worth tax.

Special Property Tax for Non-Resident Entities Owning Real Estate in Spain. Non-resident entities that own or hold real estate in Spain, whether or not the property is rented, pay taxes in Spain on such real estate.
The tax base is the *Valor Catastral* (value of the property as recorded in the municipal records, which is normally less than market value, broadly equivalent to the English rateable value) and the fixed tax rate is 3%. Tax is due on the 31 December of each year.

States, public institutions, international organisations, entities quoted on officially recognised stock exchanges, non-profit entities and entities carrying out business activities on a regular basis, other than the leasing of real estate, are exempted from this tax.

Likewise, entities residing in a country that has signed a double taxation treaty with Spain that includes a clause for the exchange of information may be exempted from this tax if they file a tax return in Spain listing (i) the real estate located in Spanish territory that they own and (ii) the last beneficial owner of the company, who must also be residents of a country that has signed a double taxation treaty with Spain that includes a clause for the exchange of information.

Special property tax for non-resident entities owning real estate in Spain shall always be applicable to entities residing in a tax haven.

**Individual Income Tax.** Non-resident individuals that own urban real estate in Spain that is not rented declare in Spain each year certain presumed revenues, which are calculated as an invariable 2% of the *Valor Catastral*. These earnings are taxed at a fixed rate of 25%. If the *Valor Catastral* has been updated by the municipal authorities, the annual revenue will be calculated as an invariable 1.1% of the updated *Valor Catastral*.

When rural or urban real estate is rented by an individual to third parties, the rent obtained will be taxed at the rate of 25%. The tax return must be filed for every rent received within a month of the date on which the owner can request payment of the rent.

**Net Worth Tax.** Net worth tax is only applicable in Spain to individuals and is levied on the value of assets situated in Spain, unless exempted by a double taxation treaty. The tax rate is progressive and varies from 0.20% to 2.50%. Property assets must be valued at the highest of the following three values: *Valor Catastral*, acquisition value or the value estimated by the tax authorities for other taxes.

**Tax on Immovable Property.** This municipal tax is levied annually on rural and urban real estate. The taxpayer is the property owner (an individual or a company, resident or not). The tax is due on 1 January of each year. The ordinary rate is 0.40% for urban zones and 0.30% for rural zones. However, municipalities have the right to increase such rates in accordance with population density and other relevant factors (provincial capitals, public transport, other municipal services, etc.)

**Taxation on the Transfer of Real Estate**

**Valued Added Tax (VAT) and Transfer Tax.** The sale of new and refurbished buildings for housing purposes is subject to VAT at the rate of 7%, and stamp duty, in general, at the rate of 1%. The sale of business premises and offices is subject to VAT at the rate of 16% and stamp duty at the rate of 1%.

The second or subsequent transfers of buildings are, in principle, exempt from VAT and, consequently, subject to transfer tax at the rate of 6% or 7% (depending on where the real estate is located) on the market value of the real estate.

The sale of more than 50% of the shares of a Spanish real estate company is subject, in principle, to transfer tax at a rate of 6% or 7%.

**Withholding Tax on the Transfer of Real Estate by Non-Residents.** In general, a party acquiring real estate located in Spain, whether or not such party is a resident of Spain, where the selling party is a non-resident (individual or company), will be obliged to withhold and pay 5% of the agreed price as a withholding on account of individual income tax or corporate income tax (capital gains) for which the non-resident seller is liable.

Exception to the obligation to make such a withholding exists when, for example, the seller is an individual and has owned the property since before 1986.

The non-resident must subsequently file the definitive tax return for the capital gain or loss resulting from the sale of the real estate, deducting the amount withheld by the acquiring party from the payable tax and, as the case may be, applying for a refund of any excess that was withheld.
Inheritance and Gift Tax. Unless a double taxation treaty exists and provides otherwise, a non-resident individual who inherits real estate located in Spain will, in principle, be taxed according to the scale for inheritance tax, which is as follows in “common territory” (Spanish territory, excluding the Basque Country and Navarre Region): sliding scale from 7.65% to 34% (in excess of €797,555.08) and application of a multiplier rate depending on the degree of kinship.

Tax on the Increase in the Value of Land. This is a municipal tax on the transfer of urban land under any title (onerous or gifts). The tax is payable upon the deemed increase in the value of the land that forms part of the immovable property in question and is borne and paid by the transferor within 30 days of the day of transfer.

The deemed increase is calculated by taking the value of the land that appears in the municipal records at the time of sale and applying to this figure a percentage, fixed by the municipality, which varies depending upon the number of complete years that the land has been held by the transferor.

Alternatives for Acquiring Real Estate in Spain

Having summarised the taxation system for non-residents investing in real estate situated in Spain, we will now explain the various alternatives for investing in Spanish property and the advantages and disadvantages of each.

Acquisition by Non-Resident Individuals. The first alternative consists of the investment by a non-resident individual in real estate situated in Spain.

Annual maintenance costs of the real estate:

• The non-resident owner must pay Individual Income Tax annually at the fixed rate of 25% on either 2% or 1.1% of the Valor Catastral. As explained above, as owners of real estate in Spain, individuals must include a presumed income each year, regardless of whether they make use of the property or not.
• The non-resident individual will also pay net worth tax annually.
• Lastly, the non-resident must pay the tax on immovable property. This tax will not affect tax planning, since it must be paid in any case by the owner of the real estate (non-resident or resident individuals and companies), unless any of the tax exemptions established by law is applicable.

Spanish inheritance tax is payable by any person who inherits or receives by way of gift any assets situated in Spain.

The advantage of this option is that it is the most simple and direct. However, it has important disadvantages, such as the obligation to pay individual income tax and the net worth tax, which are only applicable to individuals, as well as inheritance tax.

Acquisition by Non-Resident Companies. In the case of a non-resident company owning real estate in Spain, this company need not, as in the previous case, pay net worth tax and individual income tax. However, if exemption is not applicable, these companies must pay the special tax each year for non-resident companies owning real estate in Spain at the rate of 3% of the Valor Catastral of the real estate. If the Valor Catastral of the real estate has already been updated by the local authorities, this tax can be a significant amount.

The Tax on immovable property explained above is also applicable to non-resident companies.

The main advantage of the investment in Spanish real estate through a non-resident company is that individual income tax need not be paid, neither are net worth tax or inheritance tax applicable to such companies. Therefore, should the owner of the company die, the heir would not be liable for inheritance tax in Spain.

The disadvantage is that the non-resident company must pay the special tax for non-resident companies owning real estate in Spain if exemption is not applicable.

Acquisition Through a Spanish Company. This last alternative consists of the incorporation of a Spanish company by a non-resident company, which will be the owner of the real estate situated in Spain.

This alternative implies a higher initial cost, since it will be necessary to pay incorporation costs and, subsequently, the annual maintenance costs of the Spanish company. However, the Spanish company will not have to pay (i) in any case, the special tax for non-resident companies owning real estate in Spain or (ii) net worth tax or (iii) individual income tax, and (iv) inheritance tax is not applicable. This can imply significant tax savings, which would have to be compared with the incorporation and maintenance costs of the company.
Further Information

For further information, readers are encouraged to contact their regular Jones Day attorney or the principal author of this Commentaries, Pablo Baschwitz in the Madrid Office (telephone: 34.91.520.39.21; e-mail: pbaschwitz@jonesday.com). General e-mail messages may be sent using our web site feedback form, which can be found at www.jonesday.com.

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