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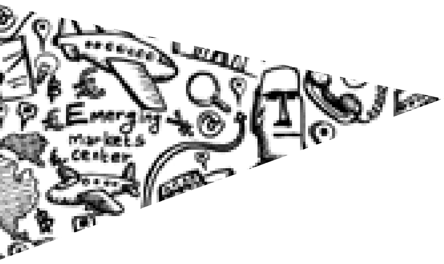

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Spanish Tax Authorities issue ruling on minimum taxation of leveraged SOCIMI (REIT) structures

Executive summary

The Spanish preferential tax regime applicable to a SOCIMI (Spanish Real Estate Investment Trusts - REITs) relies partly on the shift of taxation from the Spanish SOCIMI to the investors. However, certain investment structures have been developed effectively reducing to almost nil the overall level of taxation on the return from the Spanish property.

In a recent ruling (V3308-14, published in February 2015), the Spanish Tax Authorities clarify how to comply with the minimum level of taxation required to be paid on the dividends distributed by the SOCIMI to certain of its shareholders (those holding at least 5% of the share capital), in order to benefit from the 0% corporate income tax rate at the level of the SOCIMI.

Detailed discussion

Background

The SOCIMI tax regime provides an attractive and tax efficient vehicle to channel investments in Spanish real estate assets.

Under this special tax regime, provided that certain requirements are met, the taxation of income obtained by the SOCIMI is shifted to its shareholders: rental income and capital gains on real estate assets held by the SOCIMI will be taxed at a 0% corporate income tax rate when that income and gains are distributed as dividends by the SOCIMI either (i) to its shareholders owning less than 5% of the share capital of the SOCIMI or (ii) to its shareholders owning at least 5% of the share capital of the SOCIMI, provided that they are taxed at a minimum 10% tax rate on such dividends.

If this 10% minimum taxation test is not passed, the SOCIMI will have to pay a special 19% tax on the dividends distributed to the non-compliant shareholders.

How to determine whether the dividends are taxed at a minimum 10% tax rate

The SOCIMI Law requires that the dividends received by shareholders holding at least 5% of the share capital of the SOCIMI are subject to (and not exempt from) a minimum 10% tax, but the Law does not clarify whether this is a 10% nominal taxation or a 10% effective taxation test.

In its ruling, the Spanish Tax Authorities seem to change the criterion of prior rulings and set forth that the dividends must be subject to an effective 10% taxation (rather than to a nominal 10% taxation).

In particular, according to the Spanish Tax Authorities' view, the focus must be placed on the tax treatment of the dividend income itself, individually considered and regardless of the tax treatment applied to other items of income also earned by that shareholder, *but taking into account those expenses incurred by the latter which are directly linked to the dividend income*, e.g., (a) service fees paid in relation to the management of the stake in the SOCIMI distributing the dividends, or (b) most notably, financial expenses (i.e., interest) accrued under the financing obtained to fund the acquisition of the shares of the SOCIMI distributing the dividends.

Impact

With this approach, the Spanish Tax Authorities are clearly aiming at those structures where tracking notes or other debt or hybrid instruments are used to erode most of the dividend income obtained by the nonresident shareholder of the SOCIMI in order to reduce the global effective taxation paid on the return of the investment in the SOCIMI.

Therefore, if this criterion prevails (it is less than clear that there is sufficient support in the SOCIMI Law for such interpretation), the use of highly leveraged nonresident vehicles to structure foreign investments in Spanish SOCIMIs should be carefully revised, and alternative structures be considered.

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