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New anti-avoidance rules impact foreign real estate

(Madrid) The Tax Fraud Prevention Act, passed on November 2, 2006, will become law when the official gazette is published. The counter-fraud measures for foreign entities revolve around the concept of effective exchange of information, in line with the international trend. It is also the lack of information and not only the levy of low or null taxes in certain territories worrying developed countries with high tax rates which has caused the trend.

Besides the traditional list of territories qualifying as tax havens, there are those other countries that are eligible, as territories which exchange no information, for the application of the new anti-avoidance measures. Two such measures are to have a deep impact on a certain type of structure that has been widely used by foreign investors in the Spanish real estate market involving -offshore entities investing through intermediate Spanish companies.

The first is that the shares in the Spanish companies will be attached to tax liability arising on the capital gain realised on the disposal of the shares in the non-resident entities. The second one is that entities, but only if resident in a tax haven or in a null tax territory, shall be treated as Spanish residents, unless it is proved that they hold a larger amount of assets in other countries or if they satisfy the standard business purpose test. The actual efficacy of these two measures is dubious, but no one can doubt the intention of the far reaching consequences.

A number of technical uncertainties can be identified such as; whether the attachment will apply when shares in the Spanish company are disposed of, on which day or period of days the test for the second measure is to be made, whether entities that became resident under this new principle will be deemed to have transferred their residence abroad if they acquire a majority of non Spanish-based assets. Clearly, real estate has always been, and is too much of, a visible tax structuring object in all countries, especially Spain. Real estate is too visible for the Revenue to avoid struggling to curve practices, which in its view are only done to avoid taxes.

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