

European Public Real Estate Association
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New legal-tax regime for the Spanish REITs

In the context of the Law for tax measures aimed at consolidating public finances and boost economic activity, the Spanish Parliament has approved today a new amendment to the current regime for Real Estate Investment Trusts (in Spanish, *Sociedades Cotizadas de Inversión en el Mercado Inmobiliario*, or SOCIMIs) ("**SOCIMIs**"), in order to definitively promote their development as there have been so few in Spain until now.

The main amendment consists in the highly demanded **zero taxation of the SOCIMI** (0% tax), thus putting it on equal footing with the already existing regimes for REITs abroad.

Additionally, the reform introduces other important measures which make the previous regime more flexible and substantially improve it, including:

- The possibility of trading on multi-lateral trading systems as would be the particular case with the Alternative Stock Market (*Mercado Alternativo Bursátil*) ("**MAB**").
- Removal of requirements for the diversification of assets (SOCIMIs of a single asset), possibility of developing properties through subsidiaries, the absence of limits on maximum external financing, reduction of minimum holding period, minimum share capital required (5 million euros), etc.

This new regime is the result of the dialogue maintained between government heads of the different Spanish Ministries (Tax, Public Works, etc.) and real estate related sector players, which is why we believe it would result in the definitive step towards developing SOCIMIs in Spain as a successful real estate product.

1. Zero taxation of SOCIMIs.

The approved reform establishes a new tax regime which is radically different than the former system. The new change is the much awaited placement on equal footing of the tax regime of SOCIMIs with that of the REIT regimes which had so successfully thrived in other jurisdictions and which have as a fundamental aspect the **elimination of taxes on the SOCIMI**, transferring said tax to the final investor.

Specifically, SOCIMIs will be taxed **at a rate of zero percent** on profits obtained.

In turn, investors will be subject to taxation for dividends distributed by said SOCIMIs, which will be subject to withholdings and subject to the general taxation regime in relation to shareholders (that is, without the possibility of applying exemptions or deductions to such dividends).

Additionally, specific measures are established which ensure sufficient taxation on such dividends in relation to the members of the SOCIMI:

- A special 19% levy is established, to be paid by the SOCIMI, in those cases where the distributed dividends, in relation to certain members holding a stake equal to or above 5%, are exempt or are subject to a less than 10% tax. This mechanism (similar to the one applied in the French REIT system), is mainly focussed on foreign investors who could invoke agreements to avoid double international taxation in order to reduce (or even avoid) taxation in Spain.
- The exemption of dividends for individuals is cancelled (exemption of euros 1,500).

Likewise, the exemption in relation to the potential gain which non-resident investors may have because it involves a listed company has also been removed.

Furthermore, the new approved tax regime maintains some of the notes which already existed in the former legislation, such as the non-existence of an *ad hoc* entry tax, or the presumption that the restructuring transactions, the purpose of which is to incorporate a SOCIMI, may apply the tax-neutral system (if they comply with the rest of the requirements) for restructuring reorganisations.

Lastly, with regard to tax losses existing prior to the application of the special tax regime, it is established that their compensation with future positive tax bases may only be carried out insofar as the SOCIMI pays taxes under the general regime. This is a scenario that would only arise in cases where the asset maintenance requirements (3 years) are breached or where it incurs in any of the scenarios where it would lose its special tax regime (de-listing, failure to distribute dividends, etc).

2. Obligatory trading on regulated markets or multi-lateral trading systems (i.e. MAB).

The reform contains other traditional sector requests: the possibility of allowing trading not only on official or regulated secondary markets (stock markets), but also on Spanish multi-lateral trading systems or in any other member state of the European Union, such as the *Mercado Alternativo Bursátil* (MAB), in Spain or the Alternative Investment Market (AIM) in the United Kingdom.

Thus, SOCIMIs may choose to trade on regulated markets, complying with the generally demanded requirements for these types of markets, or alternatively to trade on multi-lateral systems which have much more flexible regulations.

Having said this, in general, in order to trade on the MAB, the SOCIMI must have a free float distributed among its shareholders. Likewise, despite demanding certain transparency, information supply and liquidity conditions, these are more lax than the enforceable conditions for trading on regulated markets.

Having said the above, it is worth mentioning that the MAB has announced the creation of a specific segment for SOCIMIs, thereby adapting the existing regulations for expanding companies to the own peculiarities of the SOCIMIs. This new segment is expected to be approved during first quarter of 2013.

Thus, this measure will provide a major incentive for smaller investments for which the numerous and strict enforceable requirements on regulated markets have until now been a major obstacle. Likewise, maintaining the obligation to trade (whether on regulated or alternative markets) safeguards the principles of transparency and liquidity which are inherent to the REIT regimes and which are shaped as an essential point for its distribution among small and medium investors.

3. Obligatory distribution of the annual's profits by means of a distribution of dividends representing at least 80% of the earnings obtained from leases.

The former SOCIMI law established the obligation for the SOCIMIs to distribute the profits obtained in the form of an annual distribution of dividends to its members.

With the reform, the thresholds for the obligatory distribution of dividends will be the following:

- At least 80% of overall profits, including the profits derived from the lease of properties.
- At least 50% of the profits derived from the transfer of assets (properties and shares and participations) eligible for the application of the special tax regime (properties used for lease and shares and/or participations in entities whose corporate object is the foregoing activities). The undistributed amount (i.e., the remaining 50%) will be reinvested in eligible assets within three years of the transfer.
- 100% of the profits coming from entities in which the SOCIMI holds a stake.

As anticipated, this requirement is one of the essential points of the REIT regimes and is present in virtually all Comparative Law systems.

4. The possibility of carrying out property development in SOCIMI subsidiaries and the reduction of the term for maintaining the asset in the event of development (3 years).

The former SOCIMI law restricted the performance of development activities in entities in which the SOCIMI held a stake.

This restriction represented a significant disadvantage with respect to property developers, who were always able to incorporate individual vehicles for each development while it was virtually impossible for SOCIMIs to promote properties with the usual structures in Spain.

The new wording of the Law removes said restriction, allowing the incorporation of subsidiaries devoted to property development which can opt for the special tax regime.

Moreover, the minimum holding terms are unified, with the minimum 3-year term applying to all properties owned by the SOCIMI, meaning that it is irrelevant whether a particular property was developed by the entity.

5. SOCIMIs with a single property asset.

According to the former SOCIMI law, the SOCIMIs had to meet certain minimum asset diversification requirements: they were obliged to have at least three properties with no single property representing more than 40% of the entity's total assets.

The reform has removed this requirement, thus making it possible to create a SOCIMI for each property asset. This measure could be beneficial in the context of major real estate projects (shopping centres, real estate complexes, buildings for administrative use), in which having one company per project is vital for the purposes of liability, obtaining licences, managing financial risk, etc., also making divestment more flexible.

6. SOCIMIs without a debt limit.

Another of the most debated aspects of the SOCIMI system and one which has raised the most doubts in terms of its practical application was the obligation for external financing to be less than 70% of the entity's assets, according to net book or market value.

The reform approved today has removed this requirement. As a result, the SOCIMIs will have no debt limit.

We feel that this new development will be very well received in the sector, and even more so, taking into account, the general limits on the deductibility of financial expenses introduced by Royal Decree 12/2012, of 30 March, which establishes different tax and administrative measures aimed at reducing the public deficit and its subsequent amendment by Royal Decree Law 20/2012, of 13 July.

7. Minimum share capital: 5 million euros (in the form of a monetary or non-monetary contribution).

According to the former SOCIMI law, the minimum share capital for a SOCIMI was set at 15 million euros.

However, with the reform the minimum capital for a SOCIMI is set at 5 million euros. It is also worth highlighting that the share capital can be subscribed using non-monetary contributions (i.e. by contributing properties to the SOCIMI), meaning that it is not necessary to make an actual monetary disbursement.

Moreover, this measure, taken in conjunction with those listed above (possibility to trade on the MAB and removal of the asset diversification requirements) will make it possible to incorporate smaller SOCIMIs.

Next steps:

As anticipated, the reform approved today by the Spanish Parliament may ensure the definitive success of the product, as said it will serve to remove or overcome the main obstacles identified by the different sectors involved to date.

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