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Tax reforms are always welcomed, no doubt especially when seeking to avoid tax fraud schemes. But whenever tax reform is not totally balanced, a zero-sum approach seems to have been taken by the lawmaker. After all, what some do not pay, others will.

One could be forgiven for thinking that this is exactly what has happened with the latest Spanish tax reform, and foreigners in particular should beware the changes.

Real estate

Picture the following: a non-Spanish investor acquires from a non-Spanish stakeholder a stake in a non-Spanish tax-resident company that is of a real estate nature. The tax reform may have a huge impact for the investor.

On the face of it, the new tax anti-avoidance rules makes sense and is technically polished. For example, it is not applicable to IPOs and it improves the calculation of the taxable base. Yet, on closer analysis, several issues emerge.

Under Spanish law, the acquisition of shares is tax-free in Spain. By contrast, it is taxed when legally regarded as a hidden real estate acquisition, which happens in two scenarios:

- If thereby the acquirer gains the control of a real estate company or, once the control is reached, if the investor increases its stake in the company. Note that the tax is triggered depending on the type of assets the target company owns and the stake acquired.

- Whether the company is of a real estate nature or not, if the stake now acquired was received by the transferor as a result of a prior real estate in-kind contribution. This rule works regardless of whether the acquirer gains control of the company.

In the second scenario it is worth bearing in mind that no tax is triggered if the stake is transferred more than three years since the in-kind contribution took place. Otherwise the investor will be taxed on the fair market value of the real estate assets that corresponds proportionally to the stake transferred.

Qualifying stakes

In the first scenario the acquirer is taxed whenever it gains the control of a real estate company as a result of the acquisition. Under the rule a real estate company is considered an entity the assets of which consist of at least 50 per cent of real estate located in the Spanish territory. For such purposes not only the real estate assets are taken into account, but also the qualifying stake the holding company may have in a real estate company.

'Qualifying stake' refers to the stake that effectively gives rise to the control of a real estate company. It is of no significance that the qualifying stake accounts for less than 50 per cent of the total assets of the holding company, provided that it gives the holding company the control of the real estate company.

In order to carry out the 50 per cent test, all of the company's assets have to be valued at their fair market value at the time the stake is acquired. However, the rule does not say anything about whether latent goodwill should be computed for such purposes.

As for 'control', this is legally reached whenever the purchaser acquires directly or indirectly more than 50 per cent of the real estate company's share capital, if of mercantile character. It is worth noting that the acquisition of indirect control also triggers the tax.

Prior to the tax reform an indirect stake was considered, but only at the time of direct stake acquisition by the investor. On the contrary, in the case of indirect acquisition, a direct stake the investor previously held was not computed in order to carry out the test of control.

What is also new is that any stake that subsidiaries within the same group may have in said real estate company will be computed. The control is linked to the 50 per cent threshold, regardless of the voting rights. By contrast, regardless of whether the acquirer has the majority of the voting rights of the company, no control is gained when the stake is lower than 50 per cent. As a result the analysis becomes complex, especially in light of the latest reform of the rules of mercantile groups of companies.

Unanswered questions

Until the new rule came into force, any further share acquisitions were tax-exempt once the investor took control of the real estate company. Now the tax is levied on all further share acquisitions over the threshold of 50 per cent.

Also, no transitory period has been set. It is important to remember that, under the former rule, tax was levied on the basis of 100 per cent of the real estate value, regardless of whether the stake was lower than 100 per cent.

But what if, prior to the new rule coming into force, an investor acquired a 51 per cent stake in the company and paid tax on the 100 per cent value of the real estate assets? Will the investor now have to pay an additional tax if it increases further its stake in the company? As for the acquisition of shares through a subscription process, the new wording ensures that the investor is taxed whenever the control of the company is obtained in "any other way". This has widened the taxable event in the extreme.

What was drafted to avoid any real estate tax fraud schemes now can be seen by some as a way for the Spanish tax authorities to collect as much tax as possible. Could tax fraud not have been battled through the Spanish general anti-abuse provisions addressed in the Spanish General Law on Taxation (Ley General Tributaria)?

Beware

In short, there are several issues still to be cleared up. Consider those companies that need to invest in real estate assets to run their business activities - hotels, for instance. If the purchaser opted for acquiring the company's assets and liabilities instead of its shares, then

the transaction would have been taxed by VAT, which in the normal run of events means no cost for the purchaser (due to the input-output VAT deduction system). The new rule should not lead the investor to bear a cost that it otherwise would not be forced to bear. Nor to any double taxation scenarios.

Disputes with the Spanish tax authorities are certain in the years to come. We are still far from knowing the criteria of the Spanish tax authorities. For the time being, to be on the safe side, it is worth rethinking how the transaction is structured. Never let it be said you were not warned about it.

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