The Offshore Tax Planning Review

5% SPECIAL TAX ON SPANISH PROPERTY OF NON-RESIDENT ENTITIES[1] THE ELEVENTH HOUR

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The 31st December of each year is the date on which this tax accrues, the first such date falling very shortly (31st December 1992). Little time therefore remains in which to compose and prepare a claim for exemption, if that is one's intention, since no claim for exemption for the current year can be granted unless such claim, complete in every respect, has been submitted to Hacienda[2] before that date. This brief note is to advise of certain recent developments in fact and in opinion. In no particular order, those developments are:

1. It has always been clear that Hacienda would be administratively unable to process all claims for exemption before the date on which the 5% becomes due for payment. It has been a reasonable expectation, however, that they would not seek the tax unless and until a claim for exemption, made in time, had been considered and refused. We now hear that they intend to collect the tax in all cases, and make repayment when in due course a claim for exemption is approved. The self-evident effect is that most entities owning real property in Spain must find the cash-flow with which to fund the tax this year, even where they believe they will benefit from an exemption.

2. The processing of exemption claims will be slow. The Dirección General de Tributos (DGT) is not an arm of the Finance Ministry which is equipped, manned, or accustomed to deal with the daily administration of taxes. Nevertheless, it is the arm made responsible for the processing of these claims. As I write, they have so far managed to obtain two additional members of staff for this purpose, and are still seeking further office accommodation.

3. The issue of how to deal with beneficial interests remains a major preoccupation for advisors, even at this late date. In considering the exemption available to those entities which declare ultimate ownership, the words of the Regulation speak of the "physical person(s) who, directly, or indirectly own[3] (the majority of) the social capital". The question to be resolved is what constitutes ownership.

   a) By and large, this is reasonably clear where companies and their shareholdings are concerned.

   b) Where nominees/bare trustees are involved, the fact that Spanish law cannot recognise beneficial title for its own domestic purposes, seems to me largely irrelevant for our purpose here. The ability to exercise control over the asset (which in my view is the core of the policy of this law) is clearly vested in the beneficial owner and not in the nominee. This seems to me to present a choice: follow the strict words of the law/regulations and

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1 This tax was discussed in detail in Volume 2, Issues 1 & 2 of this *Review*.

2 Spain's equivalent of the UK's Inland Revenue.

3 "... *las personas fisicas que, directa o indirectamente, resulten titulares de su* (the entity's) *capital social o dispongan de la mayoria del mismo...*". I have, for simplicity, translated "*resulten titulares*" and "*dispongan*" as "own". The subjunctive mood of the verbs does not significantly affect the sense. The keys are the word "*titulares*" and its interpretation.

pursue the chain of legal title until one reaches a physical person[4]; or branch off into beneficial title where that confers control.

c) In trusts where there is in interest-in-possession[5] in the majority of trust assets (where they in turn are solely the shares of the property-owning company) it seems open to the company to declare those beneficial interests. The fact that a beneficiary with an interest-in-possession cannot be said to exercise control somewhat weakens my contention here. Nevertheless, there is a major sense in which he may be said to "own" the shares of the property-owning entity. The position is not so clear where an interest-in-possession exists in less than a majority of the shares (or, where there is no intervening company, of the property itself).

d) In a discretionary trust where there has been no appointment of beneficial interests, no single member of the class(es) of beneficiaries can be said to own or control the social capital. The class itself which includes the longstop beneficiary can, perhaps, be said to do so - but that fails to meet the requirements of the Reglamento in not providing the name of a physical person or a quoted company. Further, one cannot go beyond the class of beneficiaries and look for a physical person who in turn owns or controls that class.

e) It has been argued that pursuing the shareholding chain of the trustee (trust company) also fails because the assets of the trust (which, of course, are the focus of the whole affair) do not appear on the trustee's balance sheet. This, of course, is quite true. But, although Spain has signed the Hague Convention on Trusts which would treat trust assets as a fund separate from the trustee's personal assets, it has not ratified it. Of course, where a trust is the registered owner of Spanish assets (real property, for example) it is the name of the trustee which appears on the public document as owner; Notaries cannot approve, nor Registrars register, "Trustees of XYZ Settlement". This is not because they do not wish to be put on notice of a beneficial interest - it is because beneficial interest does not exist in Spanish law. The registered owner of a Spanish asset is prima facie the outright owner. The balance sheet argument for not declaring the trustee fails in my view.

f) None of the above discussion mentions the role of the settlor. It is often the case that the settlor exercises *de facto* control by (often written) expressions of his wishes to which the trustees accede. Here, however, is one absolutely clear fact: the settlor has alienated his assets to the trust. Therefore, *de facto* control or not, he cannot be said to own the assets (unless there is a resulting trust for the settlor).

In the light of all the above, and much more, it is sad, frustrating, and grossly unsatisfactory that the law and associated regulations offer no certainty to taxpayers. Hacienda appear to be reserving to themselves, *de facto* rather than *de jure*, a massive discretion in how they will deal with this matter. The attempts of practitioners to interpret the law and regulations *a priori* are of interest both academically and in formulating an initial response for clients. Nevertheless, one rather fears that these interpretations may prove in large part inadequate, or at any rate insufficient, when practice becomes clear.

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[4] ... or a company with more than 50 individuals as shareholders or one quoted on an officially recognised stock exchange.

[5] Where the interest-in-possession is defeasible by (for example) appointment by the trustees, it should be borne in mind that an appointment away may be treated for tax purposes as an alienation of the underlying Spanish-sited property (Reglamentos (IRPF) Art 70(one)(j)).