

## **Capital Gains Tax**

Two bills have been passed by the Spanish parliament and will take effect on January the 1st, 2007: the new Income Tax Act and the Tax Fraud Prevention Act, both of which will affect non-residents owning or intending to buy a holiday property in Spain.

The Income Tax Act will change certain articles of the Non-Resident Income Tax Act affecting, amongst other things, the capital gains tax rate which will drop from 35% on net gain to 18%, which will be the same rate of tax applicable to the residents. These changes are due to EU pressure on the Spanish Government after receiving reports from foreign taxpayers complaining that the existing system discriminates against non-residents by applying a different Capital Gains Tax (CGT) to them than to residents.

Another significant change in the Law is the withholding tax that a property purchaser must pay to the Tax Office on account of the potential Capital Gains Tax liability of a non-resident seller. This will also drop from the existing 5% of the purchase price to 3%. This reduction is in line with the equivalent reduction for the CGT rate as the resulting tax will be (as of the 1st of January, 2007) substantially lower than it is under existing legislation. Also, do be advised that if a non-resident incorporates property into a Spanish Company it will not be subject to this withholding tax. If the purchaser does not make payment of the withheld tax, the property will be affected by the lowest of the following sums: either the CGT on the sale or the 3% on the purchase price.

The new Income Tax will do away with the special system regulating Asset Holding Companies. These were companies owned by at least one physical person with most of their assets not affected by economic activities. The letting of property was not considered an economic activity unless the Company had an employee and premises dedicated exclusively to carrying out business. Under the existing system any non-resident owner of real estate in this type of Company would benefit from the same CGT tax rate as individual residents if assets were disposed of by the company after one year. At present that rate is 15%.

The Tax Fraud Prevention Act creates new obligations when it comes to property transactions. First of all, in order for the Land Registry to register a transaction, the Title Deed must include the Fiscal Identification Number (NIF or NIE in case of non-residents) and the means of payment for the purchase price. Also, in order to subscribe to basic utilities (water, telephone, electricity, gas, etc.) it will be necessary to provide the reference number on the property's Local Rates Bill (Referencia Catastral). Evidently, these measures represent the Spanish Government's attempt to avoid future money laundering through real estate transactions and to use utility contracts in order to gain more control over the use of real estate property.