The Offshore Tax Planning Review

TIMESHARE AND TAXATION IN SPAIN

Jonathan Miller[1]

Background

The sale of holiday homes on a timesharing basis has been, and indeed remains, a fairly intense industry on the southern and eastern coasts of Spain. Those who purchase their week in the sun often do so with only an outline notion of what they have acquired in legal terms and rarely do so with the benefit of a lawyer acting solely on their behalf. Such intervention of the legal profession as may be perceived by those of keen eye, is commonly only in the "conveyancing", and that most often by the lawyer for the vendors; this latter is often proposed to the purchaser with the exhortation that it will save costs. Sometimes a notary will be involved, but his purpose is most positively not to look out for the interests of one side or the other, but to ensure that the transaction and the documents evidencing it meet the requirements of the domestic law.

If the purchaser's UK lawyer or accountant gets to hear about the purchase at all, that is usually post facto, and often to do with problems or questions that may have arisen in the client's mind since making his purchase.

The timeshare industry has indubitably acquired a somewhat tarnished name, usually as a result of its selling techniques; and yet there are promoters and operators who do their very best to level this tilted field. For the avoidance of doubt, I should say that this article is not an attack on an already besieged industry.

Aim

Rarely, if ever, are the tax consequences of a timeshare in Spain discussed with purchasers. This article aims to provide a little defensive armament in that respect to advisors who may be consulted on that topic at some point during their client's ownership of the timeshare. It does so, firstly, by offering a brief outline of the principal mechanisms by which a timesharing arrangement may be constructed and, secondly, by rehearsing the major Spanish tax effects of them.

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A Share of Time

There are two major avenues to structuring a timesharing system based on Spanish property, one of which is onshore in Spain, and the other offshore[2]. Although there are many variations on a theme, it is the author's experience that the vast majority of schemes falls into one of these two main categories.

Offshore

This system, often known as the Club System, generally employs an offshore company as the direct owner of the Spanish-sited real property which is the object of the timeshare. The structures employed can differ in detail, but the following two probably account for the vast majority of actual schemes in being.

In one version of this arrangement, there are (normally) 52 or 13 classes of share, each class with the right to occupation of the property in a specific week or four-week period of the year. The shares may be in registered or in bearer form and in the latter case there will be a requirement to keep the administrators of the property on notice of those currently entitled to use it. The shares of the company are directly owned by the members.

In another version of the Club System the company shares are held by trustees for the benefit of the members of the club. The club's constitution (written or reflected in some combination of the trust deed and the Articles of Association) establishes the rights of members and provides such powers as are necessary and appropriate for the proper management of the club's assets. There will be a schedule identifying each period of the year and each member/beneficiary's right to the relevant period.

Thus the timeshare owner in the versions instanced above is directly or equitably a shareholder of the company which owns the property but, significantly, does not own an asset with situs in Spain. As will later be apparent he may be said, however, to have an "economic interest in Spain"[3], by virtue of the rights to use of Spanish property conferred by his shareholding.

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2 By the use of the term "offshore" I mean throughout this article simply "outside Spain".

3 For fiscal purposes, an "economic interest in Spain" is widely defined. Matters as apparently incidental as signing a contract for the supply and use of a telephone are included. Generally, if one has to pause and consider if a matter constitutes an economic interest for this purpose, then it almost certainly does.

Onshore

This system (sometimes known as the Condominium System) is based in the Spanish Civil Code, in Title III which concerns *la Comunidad de Bienes* (which may be translated as "communal ownership"), at Articles 392 to 406.

Art 399 states that ... "*every co-owner shall have full ownership of his part and of the benefits and uses* [which would include income and profit] *thereof, including the right to alienate, cede or mortgage it, and also to assign to others the use and enjoyment thereof...But the effect upon the other co-owners of alienation or mortgaging shall be limited to that portion of the whole which would be adjudicated to the co-owner upon a cessation of the community of ownership*".

Title to the whole property is expressed in quotas, by way of a percentage or co-efficient. In the case of a timeshare there is added a note of that portion of the year to which each fraction applies, by month, week, or calendar date as appropriate. Thus the wealthy may own "20% August" and those who prefer to avoid the heat and the crowds "1.25% week 6". These quotas represent full legal title to that portion of the property in question and as such are recorded in separate deeds of title (*escrituras*) and registered in the local Land Registry.

The owner of a timeshare in the Condominium System therefore, in consequence of his registered title, receives all the protection which the Spanish law affords any outright owner of real property, since his title is full title to a part, not part title to a whole. He owns an asset with situs in Spain, and has an economic interest in Spain.

Some Effects of Title

Unsurprisingly, the tax and other fiscal consequences of ownership of real property sited in Spain generally fall upon the immediate owner (whether the company or trust in the Club System, or the individual in the Condominium System).

Any non-resident with an economic interest in Spain must appoint a Spanish resident Fiscal Representative. The representative is responsible before the fiscal authorities (which include the local municipality as well as provincial, regional and national tax authorities) for tax compliance and payment of tax and, in specific terms within the law, is jointly and severally liable with his principal for these matters. Any resident of Spain may be appointed a fiscal representative; the potential liabilities however are onerous and professionals in this field may be seen anxiously scanning the terms and conditions of their professional indemnity insurances. The penalty for failing to report the appointment of a fiscal representative within two months of becoming liable so to do is a fine of up to two million pesetas (something over £11,000 at current exchange rates). Clearly the Condominium System owner must appoint a Fiscal Representative (it may be that

administrators/managers of the timeshare scheme offer fiscal representation as a service). There are those who argue that, while the Club System company evidently needs to appoint a fiscal representative, the individual members do not. I believe this to be an unsafe view on the grounds that within the definition of an economic interest in Spain are included rights to the use of Spanish-sited real property, that is to say precisely the right which is conferred by ownership of the timeshare[4]. I have to admit that I have seen no test of this point yet.

Any person (physical or juridical, resident or not) with an economic interest in Spain is required also to obtain a Fiscal Identity Number (the NIF...or NIE for foreign individuals, and CIF for juridical persons). In the Club System this would be *prima facie* the owning company. It may be argued that the individual members escape the need for a NIF; the legislation is however drawn in terms wide enough to make it advisable, at least prophylactically (see footnote 4). In the Condominium System, patently each owner needs his NIF. The sanctions for failing to comply can be onerous, amounting to fiscal paralysis; by contrast, the process of obtaining a fiscal number, whilst bureaucratic and on occasion tedious, is simple enough. Private individuals may apply in person or through their fiscal representatives; companies and other entities need in practice to have their fiscal representatives apply on their behalf.

Relevant Spanish Taxes

Tax on Realized Gain

There is no separate capital gains tax. In the case of both companies[5] and individuals (*personas fisicas*) net realized gains are added to income and taxed as such. Individuals benefit from a form of re-basing relief in which the gain is reduced by a straight-line annual percentage after the first two years of ownership; in the case of unimproved real property this results in a nil taxable gain after 20 years of ownership. Companies do not thus benefit.

(ISS) Impuesto Sobre Sociedades (Corporation Tax)

Resident companies pay a flat rate of 35% on income and gains. Non-residents without permanent establishment in Spain pay 35% on gains and generally 25% on income (pace treaty terms and legislation for European Community residents).

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4 Precisely the same argument may be applied to the requirement for a fiscal number.

5 I use the word "companies" for brevity. Within the term I include any juridical entity which is not a physical person.

(IRPF) Impuesto Sobre la Renta de las Personas Fisicas (Personal Income Tax)

Residents are chargeable on income and realized gains at rates up to 56% (over 9,550,000 pesetas - about £54,000). Non-residents without permanent establishment pay generally 25% on gross income (no allowable deductions), and 35% on realized gains. Realized losses may be carried forward for a maximum of 5 years and offset only against gains.

(IP) Impuesto Sobre el Patrimonio (Wealth Tax)

An annual tax at rates between 0.2% and 2.5% on an individual's total wealth, calculated according to special valuation rules (which generally result in a below-market value). Residents pay on their worldwide wealth; non-residents on their Spanish-sited wealth. Companies do not pay wealth tax.

(ISD) Impuesto Sobre Sucesiones y Donaciones (Inheritance Tax)[6]

A tax on the recipients of lifetime gifts and gifts at death. Rates are up to 34%, but then subject to the application of a co-efficient which depends principally upon the degree of kinship with the donor. Spouses are not exempt and apply a co-efficient of 1, as do the children of the donor; the highest co-efficient of 2.4 is applied for the unrelated (including unmarried partners), resulting in an effective top rate of 81.6%. Residents pay on worldwide receipts, and non-residents on Spanish-sited receipts. Domicile and nationality are irrelevant.

(5% Special tax) on Foreign Entities Owning Spanish Property[7]

An annual tax of 5% of the catastral[8] value of Spanish-sited real property owned by non-resident entities[9]. The tax accrues on 31st December each year (first year 1992) and is payable during the following month of January. Non-payment can result in seizure of the property, without recourse to the court. There are exemptions available: however, the most generally applicable of these must be claimed before 31st December.

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6 A full review of this tax was contained in OTPR Volume 2 Issue 3.

7 This tax was fully discussed in OTPR Volume 2 Issues 1 & 2.

8 Catastral value - *valor catastral*. Broadly equivalent to a sort of "rateable value". Each piece of land or property has such a value which can be ascertained from the local town hall, and is used as the basis for a number of taxes on property. Historically, catastral values have seemed not to exceed 60-70% of market value, but recent increases in catastral values combined with soggy market prices have generally eroded the differential.

9 Any legal person other than an individual (physical person).

The Club System

The property-owning company may well find that Hacienda[10] considers it liable to tax. The ISS Regulations at Art 6 provide that, save proof to the contrary, an income is deemed to arise to the company when it provides services or permits use of its assets. This deemed income is presumed to be at market value, and this valuation basis is reinforced at Art 39 (headed "connected operations") where the operation in question is between, *inter alia*, connected companies or a company and its shareholders.

The company may attempt to counter such an assessment by offering proof that no such income has in fact arisen. In my opinion, however, it may be difficult for it to resist the riposte that annual rental income has been replaced by a discounted lump-sum payment (the purchase price of the member's right to his week or month). ISS Art 7(c) and Art 70(One)(h) of the IRPF Regulations (which latter applies both to companies and to individuals) say that income[11] derived, directly or indirectly, from immovable property in Spanish territory or from rights granted over such property is to be considered income[12] obtained or produced in Spain. It is common for Club System timeshare schemes to have escaped taxation under these Articles (and the regulatory predecessor, Art 19 of the ISS Regulations) often by the simple expedient of not declaring the transaction (which, of course, took place outside Spain); it is a fact that Hacienda is aware in general terms of this practice; it may be that the recently modernized, more efficient, enforcement-orientated, tax-hungry Hacienda may see its remedy in ISS Regulation Art 6.

The Club System company or trust falls squarely within the terms of the 5% Special Tax. An exemption may well be available, but the company/trust must ascertain its position and actively exert its right or pursue its claim to any applicable exemption. Failure to do so and to pay the tax can result in Hacienda exerting its right to seize the property and sell it to pay the tax and the costs thereof.

The beneficial owner does not directly own an asset in Spain (although, as I commented earlier, he most clearly owns the right against the company to use its Spanish-sited property, which right constitutes an economic interest in Spain). Provided he is not resident in Spain, he is not liable to wealth tax, nor to income tax (though see the following paragraph), nor to ISD.

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

11 The word used in the Regulation is "rendimientos", which is wider and more encompassing than the word "income". A better, though longer, translation would be "profit, yield, or return".

12 Here the word is "renta", which is strictly and specifically "income".

A beastly little provision[13] in IRPF Regulations Art 70(One)(j) purports to tax, *inter alia*, transmissions of shares or other rights carrying rights to the use of Spanish-sited real property as if they were transmissions of the underlying property itself. The tax in issue is tax on realized gain, and the provision applies both to individuals and to companies. So far as the individual timeshare owner is concerned, this does not apply on death, but would certainly apply (assuming Spain can make the provision stick, and I have some doubt about that) to any lifetime alienation.

The Condominium System

As we have observed, the owner of a timeshare in this system is a full legal and outright owner of a portion (albeit divided by time rather than space) of Spanish real property. The tax consequences are therefore no different from that of any other owner of real property sited in Spain. Assuming the owner to be a non-resident individual, his liabilities would be:

Wealth Tax

He should include the timeshare in his annual declaration. The value is the IP valuation[14] of the property multiplied by the co-efficient applicable to his share. Thus our wealthy client who owns 20% August of a property with a catastral value of 10 million pesetas would declare pts 10m x 20% = pts 2m. His crowd-shunning counterpart with 1.25% week 6 would declare pts 125,000.

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[13] ...about which I made fuller comment in OTPR Volume 2 Issue 2.

[14] ...which would normally be the catastral value.

Personal Income Tax

a) IRPF Art 34 (b) imposes a deemed income on residents and non-residents alike of 2% pa of the wealth tax value of real property retained for the taxpayer's own use. Art 49(2) of IRPF Regulations extends this to property used by the owner for recreation either permanently or during fixed periods every year, which self-evidently takes in the Condominium System timeshare. In the case of the non-resident the 2% deemed income will be taxed at 25%. Mr August will therefore be liable to 10m x 20% x 2% x 25% = pts 10,000. Mr Week 6 should pay 10m x 1.25% x 2% x 25% = pts 625. These are without doubt derisory figures, and there is no question that the sheer hassle, let alone the cost of professional accountancy fees, discourages most timeshare owners from complying with the law[15].

They should, in the new enforcement climate in Spain, be aware that Hacienda is no longer overlooking such breaches.

b) Tax on realized gain[16]. It is in practice unlikely that an owner would alienate his timeshare at, in his view, a gain. He should nevertheless inspect his title deed (*escritura*) for the recorded price of acquisition, since he may (albeit unknowingly) have paid an illegally unrecorded premium to the vendor. In consequence he may, on alienation, show a taxable gain (chargeable to a non-resident at 35%). Gifts on death (after 1st Jan 1992) are not subject to tax on realized gain.

Inheritance Tax

The gift of a Condominium System timeshare, during lifetime or at death, is chargeable to ISD on the recipient (and it should be borne in mind that spouses are not exempt). The asset is sited in Spain and therefore the transfer (or, strictly, the receipt) is chargeable irrespective of the residence of the recipient. The value is not the catastral or wealth tax value referred to above, but the full open-market value of the property multiplied by the percentage or co-efficient of the timeshare in question.

Conclusion

My overarching conclusion is, inevitably, somewhat trite: owners must check their positions, with urgency. In more detail:

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15 The same observation applies to wealth tax declarations.

16 These observations apply equally to the Club System owner if he is caught by the provisions of IRPF Regulations Art 70(One)(j).

a) Condominium System.

Most timeshare owners know nothing and suspect less of their Spanish tax liabilities; Hacienda has generally not, in the past, disturbed their slumber; it may be about to do so; there will indubitably be some sudden remedial professional attention needed; and those owners who continue to do nothing are at notable risk of unpleasant official attention which can amount to loss of their asset. Early action to set affairs right is most advisable.

b) Club System.

The timeshare owner is in a more difficult position in that he cannot directly take personal action to ensure that all is hunky-dory with Spain. The taxpayer is the company, and it may be responsive or not to requests or pressure from shareholders or beneficial owners. Nevertheless, the ultimate hostage to Hacienda is the immovable property sited in Spain, without which the timeshare is of no use or value. Many Club System companies have not even appointed a fiscal representative or obtained a fiscal number, let alone considered their tax position. They are at extreme risk.