

SOME ASPECTS OF TAX VALUATION OF REAL PROPERTY IN SPAIN

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Aim

Valuation is a difficult enough task in any language. It is in any event an imprecise science being, like beauty, a matter for the eye of the beholder. The crossing of national borders brings with it cultural differences often based in or leading to unexpected views and hence values of people, of objects, and of events. Valuation for tax purposes is merely an aspect of that, albeit usually provided with statutory definitions, accepted rules of practice, and all sorts of wriggings in pursuit of that illusory goal, objectivity.

Spain is a case in point. Many British and other practitioners have clients with interests or holdings of one sort or another in Spain. Those interests or holdings need valuing from time to time and, according to the author's experience, it is desperately tempting for the practitioner in the matter to succumb either to his own expectations (or prejudices, as the case may be) or to the client's blandishments. A spur to the writing of this article is the frequency with which we are consulted on questions of tax valuation, particularly when considering a potential realized gain from real property.

The purpose of this article is briefly to provide some information and illumination of Spain's relevant tax valuation rules and practice. It is, perhaps inevitably, somewhat pedestrian and unlikely to be described as entertaining light reading. I am also conscious that I may be deviating from recent editorial policy in submitting an article which bears not at all on UK taxation. My only excuse is that it bears on many citizens of the UK and other jurisdictions, and hence may have some relevance for their advisors.

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I acknowledge with grateful thanks the assistance of Ana Haurie of Windram Miller & Company SL in the preparation of this article.

The Taxes

The field is wide. In this article I shall confine myself to references to the following:

- Personal income tax (*Impuesto sobre la Renta de las Personas Físicas*) (IRPF)
Realized gains also are subject to this tax.
- Wealth tax (*Impuesto sobre el Patrimonio*) (IP)
- Spain's stamp duty equivalent (*Impuesto sobre Transmisiones Patrimoniales*) (ITP)
- Corporation tax (*Impuesto sobre Sociedades*) (ISS)
- Inheritance and gifts tax (*Impuesto sobre Sucesiones y Donaciones*) (ISD)

I shall need also to make reference to Spain's approximate equivalent of the Taxes Management Act, The General Tax Law (*La Ley General Tributaria*) (LGT) and to the Law of Rates and Public Prices (*La Ley de Tasas² y Precios Públicos*) (LTPP). I shall attempt to avoid referring to the Law of Administrative Procedure (*La Ley de Procedimiento Administrativo*) (LPA), although its pervasive effect cannot be entirely ignored.

The Different Bases of Valuation

Different taxes take different valuation bases. For real property, the bases employed are the following:

- A. Catastral value. The *valor catastral* is akin to a sort of rateable value, and is established in a similar way. All buildings, other than those not yet licensed for occupation following construction, and some few that have escaped attention, have a *valor catastral*, and this may be ascertained most conveniently by examining the most recent "rates" (*contribución urbana*³) receipt, or by asking the local town-hall (*ayuntamiento*).
- B. The real ("full market") value - *el valor real*, as discussed below.

² The word "*tasa*" can, and in everyday usage does, mean a valuation or an assessment or appraisal of value. However, in a specialist usage, it also means a public rate or contribution to the cost of the provision of a public service, and hence is often translated as "municipal tax".

³ Now superceded by the *Impuesto sobre Bienes Inmuebles (IBI)*.

- C. A verified real value imposed by the tax authority at any past time. This, of course, will be an historical *valor real*.
- D. A verified value, as in C. above, but in respect of the present taxable event.
- E. Acquisition price, as noted on the public deed of title (*escritura*), subject to D. or C. above.
- F. Accounting (net book) value, that is to say acquisition price (or *valor real*) minus any depreciation (the accounting rules provide only for straight-line depreciation at a normal maximum rate of 3% pa on buildings in commercial use), or plus any revaluation (since 1989 not permitted unless the gain is actually realized).
- G. Disposal price, subject to D. or C. above.

The Taxes in Turn (and Realized Gain Where Appropriate)

Remembering that I am here addressing solely the question of real property, I list below the valuation bases, and where relevant the taxable gain calculation, for the taxes mentioned earlier.

Personal Income Tax (IRPF)

Acquisition: E

Disposal: G

Realized gain is the difference between G and E. That figure is then reduced by 5.26% pa for each year over two of ownership of the unimproved property. Thus, unimproved (i.e., unstuffed with additional value) property is free of tax on the gain after 20 uninterrupted years of ownership. Where improvements have been made, the cost of these represents a new investment and commences its own 20 year run.

Corporation Tax (ISS)

Acquisition: E

Acquisition other than for valuable consideration: B

Disposal: G

Realized gain is the difference between G and in their case B or E (F for property used for commercial by trading entities). No form of indexation or rebasing relief is available for corporations.

Stamp Duty (ITP)

Throughout, the valuation basis is that of the *valor real* (B above) when dealing with transmissions of real property. It should be noted by advisors that this is one of the areas in which much pure nonsense is talked by those who purport to "know about these things", and who can arrange to sound quite convincing. It is often valuable, when confronting such people to enquire how they propose to get around ITP Art 10.1 (as amended by Ley 29/1987) which says with utter lucidity that "The taxable base is constituted of the real value of the asset transferred or of the right created or passed⁴".

Wealth Tax (IP)

IP (Ley 19/1991) Art 10.1 takes as the value of real property the greater of catastral value (A above), any verified value for the purposes of other taxes (C above), and the price, consideration, or value of acquisition (E above).

Art 10.2 deals with property under construction and charges the building cost to date together with the value of the underlying land.

Art 10.3 deals with timeshares and similar co-ownership rights. Direct proportional ownership of a property is valued at the appropriate proportion of the total; indirect ownership is valued as the acquisition price of the share or other title representing the timeshare.

Inheritance and Gifts Tax (ISD)

ISD (Ley 29/1987) Art 9 says:

In the case both of transfers *mortis causa* and gifts *inter vivos*, the value is the real value (B above) less such charges and debts as are deductible according to this law.

⁴ This is an unlitery, but literal, translation of the first sentence. The rest of the article goes on to provide calculation bases for certain types of asset and right, without diminishing in the slightest part the force or clarity of the opening sentence.

Commentary - and Some Decided Cases

The general principles applied are in the large fundamentally unsurprising, although there are one or two unexpected moments in the application of those principles. However, disputes and uncertainty about tax values are quite common. It should be remembered that there is something of a tradition in Spain - albeit plainly and specifically unlawful - of the two parties to a transaction agreeing to underdeclare the value in formal documents and hence in tax returns. It also occurs, especially where foreigners are involved in real property purchases, that the vendor will wish to insist on such underdeclaration. A perfectly astonishing number of people agree to this, and an equally astonishing number of otherwise largely professional advisors appear to lend their support to it. For the record, underdeclaration is unlawful; it can be discovered; it can be punished; and even if undiscovered at the time, the inevitable consequence is a reduced base/acquisition value for calculating the taxable gain on later disposal.

Hacienda's Right to Verify

It is important to remember that self-assessment is the rule in Spain. It is therefore incumbent on the taxpayer to report the value of a taxable transaction, according to the rules made in the relevant tax legislation. LGT Art 52 gives to the tax administration the right to verify reported values using a list of indicative procedures. Those methods include, as one would expect, average market prices, quotations on national and foreign stock exchanges (where relevant), Hacienda's expert opinion, other expert valuations, and such other methods as specifically provided for in the Law enacting the tax in question. The taxpayer is provided, in the same Article, with the right to produce his own expert valuation by way of appeal against the administration's valuation. The present law, amended with effect from 1st January 1991, adds some tie-breaker rules. The first of those says that the taxpayer's expert valuation will be accepted where the value is no greater than 20 million pesetas⁵ and where the administration's valuation does not exceed the taxpayer's by more than 10%. The second provides, where the value or valuation discrepancy is greater than that, for the appointment of a third valuer selected by lottery from a list provided by the official colleges or associations of valuers. It also provides that the taxpayer should pay the fees of that third valuer when his valuation exceeds by more than 20% the taxpayer's originally declared value.

⁵ The rate of exchange at the time of writing is approximately pts 195: £1 (after the third devaluation of the peseta in nine months). Twenty million pesetas is therefore around £103,000.

Price Versus *Valor Real*

The issue of reported versus verified values is a vexed one and one which gives rise to many questions and frequent perplexity. It derives in large part from the potential and actual conflict of views between taxpayer and Hacienda⁶ as to what constitutes the *valor real* (real or taxable value) when such value is principally defined as a full market or arm's length value. An interesting sidelight is thrown on this issue by a most telling phrase in one of the opening recitals (*exposición de motivos*) of the April 1989 LTPP: it says ... "the distinction between price and valuation is a classic question for the Public Revenue"⁷. It is clear to see that Hacienda, and indeed the Courts, are not compelled to accept that a price agreed between two unconnected parties is necessarily equal or equivalent to the *valor real* nor even that such price necessarily represents an open market price. Indeed, even a price achieved at public auction does not of right receive Hacienda's seal of approval. In a relatively recent case, the court decided that where a public auction was held by order of the court and under its supervision, it was "not appropriate" for Hacienda to commence proceedings against the taxpayer for tax and penalties on the difference between the declared (auction) price of the transaction and Hacienda's verified value. Of course, the flip-side⁸ of that judgment plays an altogether different tune: where a public auction is held other than by order of the court, it is entirely within Hacienda's right to set the auction price aside in favour of its own higher valuation (subject always to the taxpayer's right of appeal in LGT Art 52). Professor César Albiñana⁹, arguably the leading commentator in the field of Spanish taxation, goes further and rejects entirely the price of a transaction as per se representing the *valor real*. He says, in my paraphrasing, that "it is necessary to judge whether a taxpayer has correctly valued a transaction according to the requirements of the relevant law; that such valuation should not be affected by subjective criteria; and that it is never a question of declaring simply the consideration agreed or paid, that is to say the price". Patently the price may

⁶ Spain's equivalent of the UK's Inland Revenue, and an arm of the *Ministerio de Economía y Hacienda* (frequently loosely translated as the Ministry of Finance).

⁷ "La distinción entre precio y tasa es una cuestión clásica de la Hacienda Pública...." [opening phrase of the second paragraph of Motivo III of Ley 8/1989 13 abril]

⁸ I am grateful - I think - to my children for introducing me to the world of discjockey-speak. Now that I have mastered the meaning of this compound noun, I am reluctant not to show off my mastery of it.

⁹ Writing in p.197 of the *Dunbar Vida y Pensiones Guía Fiscal 1993* published by Ediciones Deusto.

indeed coincide with the *valor real*, but the one is not the sole determinant of the other.

The Tables Turned

A recent appeal case may be causing Hacienda to reconsider one of its principal, less attractive, and more off-hand approaches to the verification of reported values of real property. LGT Art 52.1.d permits Hacienda to use its own expert opinion as one of the indicative methods of checking valuations. With this fact clutched warmly to their bosoms, regional tax authorities proceeded some years ago to devise a series of tables of indicative property values according to the size, location, standard of construction, age, and other indices of the property. Whilst these may have been thought of by practitioners (and reasonably so in my view) as guidelines indicative of what Hacienda may be prepared to accept, the tax authority tended to regard them more as fiscal writ inscribed on tablets of stone. Worse, there has developed an unhealthy tendency simply to increase these values by applying annual inflation indices to them, which took them even further from the relative sanity of market value, especially at a time when inflation remained positive and property prices were adopting the characteristics of a lead balloon. In a case on 23rd November 1992 before the *Tribunal Superior de Justicia de la Comunidad Valenciana* heard by way of appeal from a judgment of the *Tribunal Económico-Administrativo Regional de Valencia*, Hacienda received a bloody nose. In some fairly downright words the Valencia Tribunal Superior decided that Hacienda's valuation tables, "in the form of a standardized document replete with little boxes", whilst worthy to be considered an opinion of a generic nature on average market prices (*sic*) within a zone, failed as an expert valuation of the property in question since it was not possible to determine therefrom either the reasoning or the specific criteria adopted in the valuation at hand, and that it contained no analytical study related to the taxable event in question. The taxpayer won. Hacienda lost. Viva sanity. Of course, it remains to be seen quite what will be the ripples from this rock in the pond. To my knowledge, nothing resembling a practice note has yet been published following this judgment.

Requirement for Justification

There is a tax-planners' saying - or if there isn't there should be - that mere asseveration doesn't cut the mustard; you must be prepared to prove it. This applies also to valuations, of course. Interestingly, in an example of the biter bit, the *Audiencia Nacional* on 29th October 1992 applied this dictum to the tax authority, quoting in particular LGT Art 121.2. In annulling a 9th September 1987 ruling of the *Tribunal Económico-Administrativo Central* as having no foundation in law (and adding that no appeal from this decision would be permitted) the *Audiencia* found for the appellant taxpayer and ordered the tax

administration to repay to the taxpayer all the costs of the bond¹⁰. What the *Audiencia* found unacceptable was that the tax administration, in imposing a higher valuation than that reported by the taxpayer, had failed to provide to the taxpayer any information about the basis for the revaluation, the criteria adopted in the valuation process, and concretely those facts and elements upon which the revaluation was based. The *Audiencia* in arriving at its decision took into account earlier (1984 and 1989) decisions of the *Tribunal Supremo* in which it had commented upon the inadmissibility of failure to provide the taxpayer with complete justification of any increase in a tax valuation.

Conclusion

I have considered in this article only real property. I have confined myself to this area mainly in order to keep the article to, I hope, a reasonable length but also because it is the area in which confusion and misunderstanding is principally encountered. That confusion has, in my view, most of its roots not only in the sometimes whimsical, sometimes officious, approach of Hacienda to the establishment of a *valor real*, but also in the time-honoured but unlawful tradition in Spain of, without further ado, deliberately understating the price (let alone the value) of a transaction. Given all of that, however, I am constantly astounded by the number of professional advisors (in Spain, or without) who prefer to rely on their faulty memory, their unsupported preference, or their personal prejudice for determining or advising on a valuation basis, rather than that provided in the current law and regulations.

¹⁰ When appealing a tax assessment it is necessary to put up a bond or guarantee equal to the disputed amount of tax.