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Spain's Stamp Duty Saga Settles With New Reform

Lenders, not borrowers, become Stamp Duty taxpayers on mortgage loans under reform law.

Key Points:

- The new law applies to all mortgage loans created after 10 November 2018, without retroactivity.
- Expenses derived from paying the Stamp Duty will not be tax-deductible by the lender for purposes of corporate income tax or non-resident income tax (for non-Spanish banks with a branch operating in the Spanish market).
- The reform may cause a repricing of loans currently under negotiation, and may lead banks to find ways to shift the cost to borrowers.

Background

The granting of mortgage loans in Spain, which must be documented in a Spanish public deed (*escritura pública*), triggers a Stamp Duty tax. This tax becomes due on public deeds that:

- Relate to economically valuable content
- Can be registered with a public registry (*e.g.*, Land Registry, Industrial Property, or Commercial Registry)
- Are not subject to Transfer Tax, Capital Duty, or Inheritance Gift Tax

Depending on the Autonomous Region (*Comunidad Autónoma*) where the mortgaged property is located, the standard Stamp Duty rates range between 0.5%-1.5% of the total liability secured by the mortgage (*i.e.,* principal, plus ordinary and default interest, plus the costs of execution). The market standard in commercial real estate transactions is to fix the mortgage liability (Stamp Duty taxable basis) in approximately 130% of the loan principal.

Article 68.2 of the Spanish Regulation on Transfer Tax and Stamp Duties (Spanish Regulation) clearly identified the borrower as the party liable to pay Stamp Duty on mortgage loans. Several taxpayers, however, had claimed that the Spanish Regulation was overreaching and not in line with the Spanish Transfer Tax and Stamp Duties Act, which defined the Stamp Duty taxpayer as the party "having an interest" in the execution of a public deed.

According to certain borrowers that have borne Stamp Duty, the party interested in documenting a mortgage loan in a public deed is the lender party, meaning that the Spanish Regulation contradicts the Transfer Tax and Stamp Duties Act and should be ruled illegal. Despite these claims, the Spanish courts have upheld the content of the Spanish Regulation for the last 30 years.

Recent Supreme Court rulings on the Spanish Stamp Duty regulation

In October 2018, one of the chambers of Spain's Supreme Court of Justice (the Administrative Chamber) issued three controversial rulings rendering null and void article 68.2 of the Spanish Regulation and overturning its longstanding criterion. The court ruled that the Stamp Duty taxpayer should be the lender, instead of the borrower, on the grounds that a mortgage security is granted for the benefit of the lender, and therefore, the lender should be deemed to have an interest on the execution of the mortgage public deed.

These Supreme Court rulings created turmoil and uncertainty in the Spanish banking market, because they could have allowed borrowers, including individuals and corporations, to claim a tax refund of any Stamp Duty. In this situation, the Spanish tax authorities could have immediately claimed the refund from the lenders in turn, provided that the statute of limitations had not elapsed (*i.e.,* four years after the 30 days following the granting of a mortgage loan).

On 6 November 2018, the Supreme Court of Justice, in its plenary session, overturned the Administrative Chamber's rulings and reinstated the previous interpretation of the Spanish Regulation, which it declared valid and in line with the Spanish Transfer Tax and Stamp Duties Act.

The response of the Spanish government

This latest Supreme Court decision caused further uproar and public outrage, prompting Spain's Socialist government to urgently reform the Spanish Transfer Tax and Stamp Duties Act through the enactment of Royal Decree-Law 17/2018. This law clarifies that the lender, not the borrower, will be the Stamp Duty taxpayer for mortgage loans entered into after 10 November 2018, the law's date of entry into force.

Parties active in the Spanish real estate market should note that this tax reform:

- Applies only to taxable events occurring after 10 November 2018, without retroactivity
- Applies to all mortgage loans, regardless of the type of loan, or the purpose or status of the borrower (*i.e.,* whether the borrower is a consumer, individual, or corporation)

Non-deductibility of expenses

Lastly, the Royal Decree specifies that the expenses derived from paying the Stamp Duty will not be tax-deductible by the lender for purposes of corporate income tax or non-resident income tax (for non-Spanish banks with a branch operating in the Spanish market). This rule will apply to fiscal years starting on or after 10 November 2018 and will increase effective costs for lenders.

If Stamp Duty costs are not tax-deductible, and they are ultimately re-charged to borrowers through an indemnity payment, or another mechanism that leads to the recognition of taxable income for the lender, the lender would effectively suffer double taxation over such amounts.

What happens next?

The practical consequences of the Royal Decree on the borrower-lender relationship remain unclear.

The non-deductibility of Stamp Duty expenses may be particularly troublesome for Spanish-resident lenders (or Spanish branches of foreign lenders), which may be in a worse position relative to non-Spanish lenders.

Likely this tax reform will cause a repricing of loans under negotiation, or may lead banks to find ways to shift the cost to borrowers (*e.g.*, by overfunding, charging upfront fees, or proposing other kinds of contractual arrangements to recover the amounts payable).

In practical terms, parties may still contractually agree, any sort of arrangement which allows the lender to recover from the borrower the Stamp Duty costs — even though such costs should be borne by the lender in its capacity as a taxpayer. Although freedom of contract is a cornerstone of Spanish law, a rogue judge could consider any arrangement put in place to recover Stamp Duty costs as an abusive or unfair provision that could be deemed null and void. The current regulatory trend to protect consumer rights in Europe following the economic crisis — and the abundant case law recently produced by the European Court of Justice in respect to abusive clauses — has permeated the mindset of many Spanish judges, making them particularly sensitive and alert to this kind of issues. Corporate loans, however, may be spared from such rationales.

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