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Information alert

Banking and Financial/Tax

NEW ASPECTS INCLUDED IN THE ROYAL DECREE 18/2012 OF 11 MAY REGARDING REORGANISATION AND SALE OF REAL ESTATE PROPERTY IN THE FINANCIAL SECTOR

The approval of Royal Decree-Law 18/2012 (“RDL 18/2012”) implies a further step by the government in its reorganising process of the balance sheets of credit institutions, after Royal Decree-Law 2/2012 was enacted in February this year, in order to provide credibility and instil trust in the Spanish financial system and endeavour to boost the recovery of the credit activity of these institutions.

In a supplementary manner, RDL 18/2012 also includes certain tax measures to guarantee tax neutrality in the transactions required to implement it and to promote the sale of real estate property.

I. Additional coverage for credit institutions when financing real estate in normal conditions

The credit institutions and consolidated groups of credit institutions must provide the following additional coverage at one time for their live balances on 31 December 2011 related to financing land for real estate development and real estate constructions or developments concerning their business in Spain:

| Type of financing for real estate construction or development | | Coverage percentage |
|---|------------------------|---------------------|
| With mortgage guarantee | Land | 45% |
| | Development in process | 22% |
| | Finished developments | 7% |
| With no guarantee <i>in rem</i> | | 45% |

If this coverage has not been fully applied by 31 December 2013, any surplus must be used to cover the assets determined by the Bank of Spain (therefore the surplus can not be paid out as dividends to the shareholders).

These institutions and groups must make the aforementioned provisions prior to 31 December 2012, except the credit institutions that carry out integration processes in the financial year 2012, which will be allowed a term of 12 months counted from the time they obtain the required authorisation to make these provisions. For such purpose, the term stipulated in the Royal Decree-Law 2/2012 is extended for applying for the authorisation of these integration processes until 30 June 2012.

The credit institutions and consolidated groups of credit institutions must submit a plan to the Bank of Spain by 11 June 2012, in which all the measures that they intend to adopt to effectively make the aforementioned provisions must be detailed and must include a disinvestment scheme of the assets related to real estate risks and a schedule to carry this out.

If, according to the plan, it is detected that, once the required provisions have been made, there will be a deficit in the main capital or accounted equity, the measures that will be adopted in order to avoid such deficit must be included in this plan and the term for its execution must not exceed five months.

The credit institutions that have preferential shares or debt instruments with mandatory conversion in shares in circulation, issued prior to 12 May 2012, or swapped for the former, may include the request to defer payment of the planned remuneration in the plan for a term no longer than 12 months, even if, due to the reorganisation to be carried out according to RDL 18/2012, there are not sufficient profits or reserves to be paid out or there is a deficit in equity of the issuing or parent credit institution. Payment of the remuneration deferred in this way may only be carried out after the deferral term has elapsed if there are sufficient profits or reserves to be paid out and there is no deficit in the equity of the issuing or parent institution.

The plan must be approved by the Bank of Spain within a term of 15 business days and such body may require the modifications or additional measures it deems necessary, among which may be a request for financial support from the Fund for Orderly Bank Restructuring (FROB) (by means of subscribing to shares or contingent convertible notes –CoCos–), in order to guarantee the provisions will be made, as required by the RDL 18/2012.

Apart from the administrative liability that could be claimed against the credit institution and those holding administrative and management positions in them, serious infringement of the measures included in the plan approved by the Bank of Spain that would jeopardise the targets in such plan from being achieved could also imply the intervention of the FROB in the credit institution.

II. Real estate management companies

The assets awarded and received as payment for debts related to land for real estate development and real estate constructions or developments obtained from the business of the credit institutions in Spain must be contributed by these credit institutions to a joint stock company (*sociedad anónima*) within the maximum term allowed, depending on the case, to make the additional provisions mentioned above.

In the case of institutions in which the majority of the capital is held by the FROB and institutions in which the Fund has been assigned as provisional administrator, this Fund will be the one to decide whether or not the credit institution must incorporate a company planned for the aforementioned mission.

The contributions to these management companies will be appraised at their fair value. If no fair value is available or it is difficult to calculate, they will be assessed at their book value, which will be calculated taking into consideration the provisions that must have been made for the assets according to both Royal Decree-Laws mentioned above. In the event that these provisions have not been made for the assets at the time of their contribution to the company, they must be completed by the company benefiting from the contribution. The aforementioned appraisal will replace the independent expert's appraisal set forth in the Spanish Capital Company Act, providing the contribution is made within the schedule for making the provisions that the contributing institution

must meet.

According to the information received after the meeting of the Council of Ministers that approved RDL 18/2012, the appraisals will be made by two independent experts of recognised prestige.

The companies in which the credit institutions hold a stake that receive financial support from the FROB must (i) have a relationship with the contributing credit institution of at the most an associated company over a term of 3 years (this means, the majority of their share capital must have been sold to third parties) and (ii) sell at least 5% of its assets every year to a third party other than the contributing credit institution or any company in its group.

TAX SYSTEM APPLICABLE TO THE REAL ESTATE CONTRIBUTIONS TO THE ASSET MANAGEMENT COMPANIES AND TAX MEASURES TO BOOST THE REAL ESTATE MARKET

RDL 18/2012 includes two sets of tax measures aimed at (i) extending the applicable special tax system to restructuring transactions that could be carried out by the financial sector regarding the asset management companies due to the obligation imposed by the aforementioned RDL, and (ii) boosting the real estate market by including a new tax benefit consisting of partial exemption for future sales.

Regarding the first set of measures, it should merely be recalled that, for tax purposes, there is already a special tax system for restructuring transactions, such as mergers, spin-offs, asset contributions and securities swaps (deferral system), which aims at tax neutrality for these transactions, so that the taxation does not harm them being carried out. Despite the foregoing, this system is only applied to transactions in which the requirements stipulated in the regulations are met and providing there are valid economic reasons for carrying them out.

In fact, the aforementioned RDL states that, in order for taxation to neither be a hindrance for the financial sector in creating or contributing assets from a real estate source to these management companies, the special tax system mentioned above will be applicable to the transactions they perform, fulfilling that set forth in the RDL, without being necessary that the stipulated specific requirements are generally met. However, we consider that the very RDL implies a presumption of valid economic reasons for these asset contributions, bearing in mind that such transactions are carried to comply with a legal directive.

In addition, but with the same target of tax neutrality, there is a possibility of not applying the exception to the exemption stated in article 108.2 of the Spanish Securities Market Act to the aforementioned real estate contribution transactions, therefore the subsequent transfers of shares to asset management companies due to the legally imposed contributions will be exempt from added value tax and property transfer tax, even if they are carried out prior to three years having elapsed counted from the date of the contribution.

Regarding the second set of measures adopted in order to boost the real estate market, RDL 18/2012 allows a partial exemption of 50% for three direct taxes (Corporation Tax, Personal Income Tax and Non-Resident Income Tax), applicable to the profits or capital gains obtained from future sales of urban real estate acquired between the date RDL 18/2012 came into force, which was 12-5-2012, and 31-12-2012.

It is therefore a partial exemption for the purchaser, in other words, the one that acquires these properties in this period of 2012 can apply the partial exemption when they are sold in the future.

It should be borne in mind that while the purchase of the property must always take place between 12-5-2012 and 31-12-2012, the exemption for the purchaser of the property has no time limit whatsoever as far as the date when the property must be sold is concerned.

Similarly, application of this tax benefit is generally excluded for acquisitions or sales carried out with a person or institution that is involved in any of the situations mentioned in article 42 of the Spanish Commercial Code (*inter alia*, holding the majority of voting rights), or when they are carried out with the spouse of this person or any person related thereto by a direct or collateral blood or kinship relationship up to the second degree inclusive.

Regarding the special aspects of these modifications to be pointed out related to the taxes involved as mentioned above, special attention should be paid to Corporation Tax, for which an additional requirement is imposed for the purchaser, because the exemption will only be applicable to the sale of urban real estate that is considered, from an accounting standpoint, long-term assets or have been classified as long-term assets held for sale (which, in spite of this name, are recorded in the short-term assets in the structure of the balance sheet, according to the Spanish General Accounting Plan). Therefore, the correct definition of such assets and therefore their correct accounting becomes an indispensable aspect when applying the benefit and could be a central issue in an inspection, if its application is examined.

We consider that with this accounting limitation, the exemption seems to be reserved for companies that, even though purchasing and selling real estate is not their main business, intend to invest in these kinds of assets, either to immediately resell them or use them in their business as fixed assets or for rental and later sell them.

It is also expressly stated that the partial exemption is applicable in addition to the deduction for reinvestment of extraordinary profits, which means that the profit obtained from the sale of these properties would be charged an effective tax rate of 9%, if such tax benefits are applied at the same time (at the Corporation Tax rates applicable on today's date).

Regarding Personal Income Tax, the compatibility with the system of tax exemption of capital gains obtained from the sale of a taxpayer's normal residence and that are reinvested by purchasing a new home is regulated by first applying the exemption and, secondly, the aforementioned exclusion system for the rest of the capital gains.

There is no special aspect that needs to be pointed out regarding Non-Resident Income Tax, except the obvious requirement that the urban real estate must be located in Spanish territory.