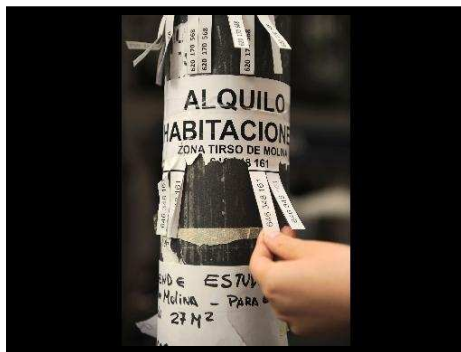




Spain's Tax-Cheat Landlords Add to Rising State Debt (Update1)

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By Sharon Smyth



Feb. 3 (Bloomberg) -- More than half of Spain's landlords are dodging taxes as the rental market expands, depriving the financially strapped government of more revenue each year.

Owners are asking for payment in cash from tenants to avoid tax on 2.5 billion euros (\$3.5 billion) of earnings annually, the **Gestha union** of tax inspectors estimates. An increase in rental properties nationwide hasn't generated any more tax revenue.

The Spanish government, seeking to pull the country out of its deepest recession in 60 years, needs all the money it can get right now. The slump was triggered by a crash in the housing market and has left

Spain with the highest budget deficit since at least 1980. Taxes go unpaid on income equal to about a quarter of gross domestic product, Gestha estimates.

"The deep economic crisis in which the country is submerged is once again making the hidden economy flourish," said Juan **Jose Figares**, chief analyst at Link Securities in Madrid. "The government will be compelled to clamp down on rent fraud."

A drop in house prices starting in the second quarter of 2008 has forced many people who bought homes as investments to seek tenants for their properties rather than selling at a loss. At the same time, more Spaniards are trying to lease homes after they were priced out of the market in the years before the crash, making it easier for landlords to strike deals that don't involve the taxman.

The number of properties for rent increased 18 percent to 2.2 million units in 2008, according to data from Spain's Housing Ministry. Rental income declared by landlords rose by just 0.1 percent over the same period, a **report** on the Web site of Spain's **tax office** shows.

Room to Grow

The rental market has a lot of room to grow. At 13 percent, the proportion of renters to homeowners in Spain is still low compared with other European countries, where 40 percent to 60 percent of housing is rented, according to Madrid-based property consultant **Aguirre Newman**. Around 65 percent of Spaniards aged 25 to 29 live with their parents, compared with about 22 percent in France and the U.K., economic research institute Fedea estimates.

"During the housing boom, the state was earning so much from home sales that it wasn't worth chasing the odd landlord," said Fernando Encinar, co-founder of **Idealista.com**, Spain's largest real estate Web site. "Now, with the economic crisis, the government really does need the money and will make efforts to prosecute tax dodgers."

Easy to Dodge

Encinar, whose company lists 360,000 properties for rent and purchase, said Gestha's estimate that 54 percent of landlords are ducking taxes "falls short of the true figure, which is set to grow further."

The penalty for avoiding tax on rent is a fine equivalent to 150 percent of the unpaid amount, according to the Spanish tax office. The tax also must be repaid. There is no punishment for the tenant.

The penalty is almost never applied because tax dodgers are not being investigated, Gestha General Secretary Jose Maria Mollinedo said.

"As both the landlord and the tenant make an agreement not to declare tax or their residency, there is absolutely no way to prove that tax fraud is taking place and therefore no non-declaring landlords are brought to book," Mollinedo said.

A tax break adopted in 2008 accounts for part of the difference between rising rentals and the lack of tax revenue growth. It gives landlords a 100 percent tax break if they rent to tenants who are under 35, according to a spokesman for Spain's tax office who declined to be identified by name, citing government policy. He didn't provide information on how many landlords claimed the tax break.

Weak Incentive

The incentive makes little difference because most leaseholders are over 35 and landlords worry that the break will be repealed in a couple of years, after they're all registered with the state, Mollinedo said.

Spain can ill afford to lose revenue it should be collecting. The country, which had a record budget surplus equal to 2 percent of GDP in 2006, will probably have an overall public-sector deficit of 9.8 percent this year, according to Finance Ministry data submitted to the European Commission today.

Sellers pay 18 percent capital gains tax in Spain on any profit made from home sales. There were 106,273 transactions in the third quarter of 2009, according to the most recently published data from the housing ministry. That was 14 percent lower than a year earlier and 58 percent less than the market's peak in the second quarter of 2006. Values decreased as much as 11 percent last year, Idealista.com said.

Tip of the Iceberg

Rent fraud is just the tip of the iceberg, with Spaniards avoiding tax on income of 240 billion euros, equivalent to 23 percent of the economy, according to Gestha. If Spain could reduce that figure 13 percent, the country generate another 25 billion euros of tax revenue annually, it said.

Tenants, happy to find a place at all, aren't likely to turn into whistleblowers. While rents fell 8.4 percent in Madrid and 12 percent in Barcelona during the first half of 2009, increases over the previous five years continue to squeeze budgets. Rent levels climbed 28 percent in the capital and 56 percent in Barcelona in the five-year period.

Ruben Gonzalez, a 33-year-old Madrid resident, said he received 120 calls in four hours after placing an advertisement in Idealista.com for a 2-bedroom apartment on behalf of his current landlord. Then he turned his cell phone off.

Gonzalez showed the first 30 callers around the 60-square-meter (645-square-foot) city center apartment, which has a broken refrigerator and faulty boiler, rising damp and peeling paint.

"Everyone was fighting over the place because it's better than a lot of what is out there and the owner is legal and insists on a contract," Gonzalez said. "One couple even offered to pay more than the asking price and another offered a cash bribe to put them at the top of the list."

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