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Spain Tax Alert

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Broad-based corporate tax reform proposed

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The Spanish government presented a broad-based draft tax reform package on 20 June 2014 that proposes the introduction of a new corporate income tax law, as well as extensive changes to the personal income tax, nonresident income tax, VAT and general tax law. The reform initiative is designed to address the country's budget deficit, stimulate investment and help to make Spanish companies more competitive abroad. Certain measures, such as a new anti-hybrid rule and changes to the controlled foreign company rules, clearly are Spain's response to the OECD base erosion and profit shifting (BEPS) initiative. If approved, the reform measures would apply as from 1 January 2015.

This alert looks at the most relevant measures included in the proposed new corporate income tax law and rules affecting the nonresident income tax.

Tax rate

The general corporate income tax rate of 30%—one of the highest in Europe—would be reduced to 28% in 2015 and to 25% in 2016.

Tax-deductible expenses

To offset the reduction in the corporate income tax rate and to broaden the tax base, limits would be introduced on the deductibility of various expenses:

- In response to the BEPS initiative, a special anti-abuse rule for hybrids would operate to disallow deductions for expenses incurred in transactions with related parties where, as a result of different tax characterizations, income would not be subject to tax, no income would be generated or the income would be subject to a nominal tax rate of less than 10%.
- Intragroup profit participating loans would be characterized as equity instruments (rather than debt) and, therefore, "interest" payments on such loans would be nondeductible.
- The general limit on the deductibility of net financial expenses (i.e. 30% of EBIDTA) that exceed EUR 1 million would remain unchanged. However, an additional limit would be introduced for leveraged acquisitions that would limit the deductibility of interest on loans obtained to purchase shares in a company to 30% of the acquiring company's operating profit (without taking into account the operating profit of the acquired entity).

This measure aims to restrict debt push-downs on leveraged acquisitions where the target and the acquisition vehicle form a consolidated tax group or are merged.

- The impairment of fixed assets would be nondeductible, although assets still could be depreciated. (This measure would complement the recent abolition of deductions for impairment losses with respect to shares representing an equity participation in the capital of a Spanish or foreign entity).
- The depreciation tables in the tax regulations would be simplified, but accelerated depreciation for R&D activities would remain intact.
- Customer or supplier entertainment expenses would be deductible only up to 1% of the company's turnover.

Tax loss carryforwards

Several substantial changes are proposed to the rules governing net operating losses (NOLs):

- NOLs would be able to be carried forward indefinitely (currently, NOLs may be carried forward for 18 years).
- As from 2016, NOLs generally would be able to be set off against only up to 60% of the prior year's taxable base, although NOLs that do not exceed EUR 1 million would be able to be set off without limitation. The existing general limitation based on an entity's turnover would remain in effect for 2014 and 2015 (i.e. where turnover is more than EUR 20 million but no higher than EUR 60 million, losses carried forward may offset only 50% of taxable income; where turnover is more than EUR 60 million, the limit is 25% of taxable income).
- The change in control rules for entities with NOLs would be modified. The use of NOLs of an acquired entity would be disallowed if that entity does not carry out any activities for three months (currently, six months) or if, within the two years after the acquisition, the acquired entity carries out different (or additional) activities from the activities it carried out before the acquisition that generate turnover that exceeds more than 50% of its average turnover for the two years prior to the acquisition.
- The tax authorities would be granted the right to audit and review NOLs for a period of four years after the NOLs are utilized (as opposed to a period that runs from the time the NOLs arise).

Tax credits

Several tax credits would be abolished (including the environmental investment credit, the reinvestment credit and the profit investment credit) and would be replaced by a capitalization reserve under which companies would be able to reduce their taxable base in an amount equal to 10% of the increase of their net equity in a particular year, provided they book a nondisposable reserve for the same amount. The R&D tax credit would be maintained and, in certain cases, the deduction rate could be up to 50% of qualified expenses.

Participation exemption

Under Spain's participation exemption, dividends and capital gains are exempt from tax if received by a Spanish entity that holds at least 5% of the share capital or equity of a foreign entity for a continuous period of at least one year, provided the foreign entity paying the dividends is subject to a tax comparable to the Spanish corporate income tax (this requirement is deemed to be met if the dividend-paying entity is resident in a country that has concluded a tax treaty with Spain that contains an exchange of information clause) and resident in a country that is not a tax haven, with at least 85% of its profits deriving from business activities. The government has proposed changes to the requirements to qualify for the regime.

A potentially significant change included in the proposals is the extension of the participation exemption—currently available only in respect of foreign investments—to apply to dividends received from, and capital gains on the disposal of, Spanish subsidiaries. Transitional provisions would apply for 2015 and 2016 to limit the exemption to 30% and 60% of gains that do not correspond to a net increase in the reserves of the company being disposed of during the seller's period of ownership. Gains would be fully exempt as from 1 January 2017.

Under the existing regime, one of the requirements to benefit from the participation exemption on dividends or capital gains is that the Spanish company generally must hold, directly or indirectly, at least 5% of the share capital or equity of the dividend-paying foreign company. A Spanish company subject to the holding company (ETVE) regime may qualify for the participation exemption with a participation of lower than 5%, if the acquisition price of the participation exceeds EUR 6 million. The qualifying participation price is proposed to be increased to EUR 50 million (for all entities).

Another requirement to benefit from the participation exemption is that at least 85% of the foreign company's profits from business activities must come from active business activities carried on outside Spain (85%/15% test). The proposed tax reform would abolish the active trade or business requirement. Instead, the foreign company would have to be subject to a nominal tax rate of at least 10%, and the participation exemption would not apply if the dividends or capital gains received generate a deductible expense for the taxpayer.

Transfer pricing

Proposed changes to Spain's transfer pricing rules include the following:

- The definition of related parties would be revised so that shareholders and entities (whether or not listed) would be deemed to be related where the shareholder participation is at least 25% (currently 5%) or where decision-making power is (or may be) exercised
- The hierarchy of valuation methods to determine the fair market value would be abolished, and other methods would be accepted, provided they respect the principle of fair competition.
- Simplified documentation requirements would be introduced for entities that are not members of the same consolidated group and whose turnover does not exceed EUR 45 million.
- The penalty regime would be made less burdensome.

Special regimes

The government has proposed changes to the consolidated tax regime and the CFC regime. Additionally, the draft law would eliminate deductions for the amortizations of goodwill resulting from a merger.

Consolidated tax regime: Measures are included in response to the recent decision of the Court of Justice of the European Union in which the court ruled that the Dutch fiscal unity regime is incompatible with the freedom of establishment principle in the EU treaty. Under Spain's current tax consolidation regime, a group of corporations may be taxed on the basis of a consolidated balance sheet, provided certain requirements are met. However, tax consolidation is not allowed between a Spanish parent and its Spanish second (or lower) tier subsidiary held by one or more EU intermediary companies, nor is it possible for two Spanish subsidiary companies held by an EU parent company to form a fiscal unity between themselves.

The following changes are proposed to the consolidation regime:

- The percentage of voting rights required to form a consolidated group will remain at 75% (70% for listed companies), but the Spanish parent would be required to hold more than 50% of the voting rights.
- Spanish subsidiaries held indirectly through a foreign intermediary company would be able to be part of a consolidated group.
- Permanent establishments of foreign entities would be permitted to become members of a Spanish consolidated group if certain requirements are met.

Controlled foreign corporation (CFC) regime: In response to the BEPS initiative, changes to the CFC rules are proposed. A Spanish entity would be required to include in its taxable base income derived by a CFC from the transfer of assets and rights, or where the CFC earns service income and there are no material and personal resources at the level of the CFC. Additionally, certain types of income (e.g. income derived from industrial and intellectual property, technical assistance and image rights) would be deemed to be passive income and, therefore, subject to the CFC rules.

Nonresident income tax

Income derived by a nonresident (i.e. nonresident without a permanent establishment in Spain) generally is subject to a final tax of 24.75%, although different rates may apply depending on the type of income. For example, dividends, interest and capital gains are subject to a 21% withholding tax rate. It is proposed to reduce the general 24.75% rate down to 19% (20% in 2015 and 19% as from 2016) for income derived by residents of the EU/EEA and to 24% in 2015 for all other nonresidents. The withholding tax rate on dividends, interest and capital gains would be reduced from 21% to 20% in 2015 and 19% in 2016.

Share premium distributions currently reduce the tax basis of the shares, with any distribution exceeding the amount of share premium being treated as dividends. Under the reform, it is proposed to treat share premium distributions made by an unlisted company as dividends to the extent of the profits earned by the distributing company during the period in which the shares have been held by the recipient. For nonresidents, this may have an impact on the amount that is subject to Spanish withholding tax.

Comments

No dates for parliamentary debate on the draft bill have been announced, but proposed rules would become effective on 1 January 2015, the legislative process would need to be finalized by December 2014 to meet this deadline. Changes to the draft bill are likely to be made before it is finalized.