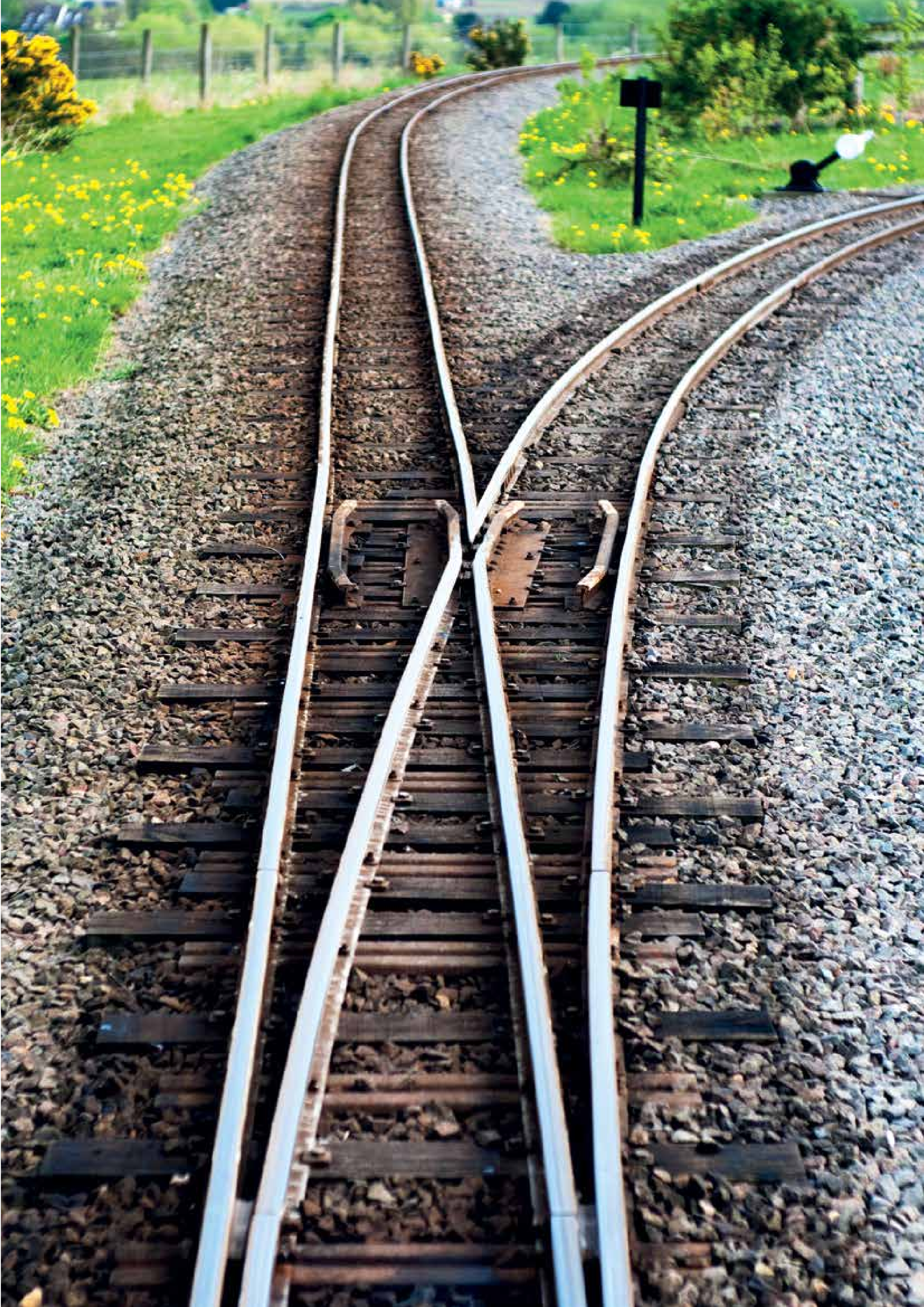
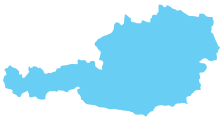
New tax regulations impacting investment funds

Austria Luxembourg Spain

At a time when new tax regulations are redefining the investment management industry, it is important to reflect on these upcoming changes and the consequence to the industry in the context of intense international pressure. The below articles present and analyse the impacts and repercussions of these new tax regulations in Austria, Luxembourg and Spain, which is of significant relevance for foreign asset managers and private banking clients.





Austria

New tax reporting scheme for Austrian funds

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The new tax reporting scheme could bring tax advantages for investors but might require funds or their administrators to provide Austrian tax representatives with a wider range of tax relevant information. The new rules will further have significant impact on the interaction between the OeKB and the Austrian tax representatives of funds. Furthermore, a new withholding tax will be applicable to specific foreign investors on Austrian interest income as part of taxable income from funds as of 1 January 2015.

On 5 May 2014, the Austrian Ministry of Finance (AMF) and the Austrian Kontrollbank (OeKB) presented the new tax reporting scheme for domestic and foreign mutual, real estate and alternative investment funds in Austria.

The new reporting scheme will amend the reporting process between Austrian tax representatives of the investment funds and the OeKB. In particular, the following processes will be implemented:

- **Reporting of the tax bases for the calculation of the capital yield tax (KESt)** on deemed distribution income and the distributions by the Austrian tax representatives of domestic and foreign funds in Austria to the OeKB
- **Calculation and dispatch of the relevant tax amounts for the purpose of the KESt by the OeKB** to the Austrian tax representatives for sign-off within the reporting deadline (seven months after business year-end for KESt on deemed distribution income and one day before distribution day for KESt on distributions)
- **Publication of the taxation of distribution income and distributions deemed taxable** for several types of Austrian investors (individuals and legal entities, private foundations) on the homepage of the OeKB

The new reporting process will not result in effective changes for the calculation of the distribution income and distributions deemed taxable.

However, the number of reporting codes that Austrian tax representatives have to dispatch will substantially increase. Currently there are six mandatory and an additional nine optional reporting codes for the reporting of distribution income deemed taxable. There are also four mandatory and an additional five optional reporting codes for the reporting of distributions. In future, however, funds might be required to provide about 60 mandatory codes, which are different for mutual, real estate and alternative investment funds.

The AMF and the OeKB might reduce the number of mandatory codes in order to avoid massive zero reporting in case specific mandatory codes do not apply to the respective fund and to limit the anticipated administrative burden on tax representatives, funds and administrators.

The amended tax reporting scheme should become applicable for **business years starting after 31 December 2014 at the latest**. Accordingly, the current tax reporting scheme will be applicable due to a draft ruling issued by the AMF on 17 July 2014 for reporting of distribution amounts and distributions deemed taxable **referring to business years which start before 1 January 2015**.

The new reporting scheme will amend the reporting process between Austrian tax representatives of the investment funds and the OeKB

Furthermore, the AMF announced in the above-mentioned draft ruling that interest income as defined under the regulations for the European withholding tax in the European Union Savings Directive (EUSD) which qualifies as Austrian interest income is subject to 25% capital yield tax (KESt) if derived by specific foreign tax residents after 1 January 2015. Foreign tax residents who hold a custody account in Austria and are **individuals resident in a non-European country—and corporations resident outside Austria**—and not subject to the regulations of the EUSD as applied in Austria will be subject to the new capital yield tax. Funds planning to report the relevant interest income daily and as part of the annual deemed distribution income, or as part of distribution, may report the relevant KESt figures to the OeKB until 14 November 2014. The OeKB will then publish a list with the funds planning to report the interest income and the KESt thereon.

New reporting codes will have to be applied for the daily, annual and distribution reporting. The daily figures will have to be reported **by the fund** or its administrator to the OeKB, the annual reporting and the distribution reporting will have to be effected **by the Austrian tax representative of the fund to the OeKB**.

The above-mentioned new KESt reportings are optional and have nothing to **do with the tax reportings for Austrian investors**. If a tax transparent or reporting fund decides not to report the new KESt figures relevant for foreign investors, the tax transparent status for Austrian investors will remain. In this case if a foreign investor (as described above) holds shares in a fund with an Austrian depository bank, 25% capital yield tax will be deducted on a lump sum tax base. The investor is entitled to credit the tax against the tax in his home country and claim for a refund of the non-creditable part of the capital yield tax in Austria due to the applicable Double Taxation Treaty, unless there is no relief at source in Austria, with respect to which the AMF has announced that it will publish further regulations.

The amended tax reporting scheme should become applicable for business years starting after 31 December 2014 at the latest

Luxembourg

Implementation by Luxembourg of the standards for the transparency and exchange of information for tax purposes

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By way of introduction, there are three different methods for exchanging information:

- **On request (on demand):** A State shall request from another State to provide information on a case-by-case basis.
- **Automatic:** States shall automatically exchange agreed information (income, frequency, format, etc.).
- **Spontaneous:** A state shall without prior request forward to another State information of which it has knowledge under a number of circumstances.

Luxembourg takes actions at both international and European levels to apply the different types of exchanges of information.

1. Luxembourg's actions to become compliant with the OECD's Global Forum on Transparency and exchange of Information for Tax Purposes

As reported in the media, in November 2013 Luxembourg received a non-compliant rating from the Global Forum on Transparency and Exchange of Information for Tax Purposes (hereafter 'the OECD's Global Forum').

You will find hereafter the Luxembourg actions to become compliant. Luxembourg will ask for reassessment as soon as possible on the basis of the new measures and laws under way. For the sake of completeness, you will first find a few words on what the OECD's Global Forum is.

Set up in the early 2000s, the OECD's Global Forum is a multilateral framework in connection with the tax transparency and exchange of information. The forum is one of the largest tax groups in the world with more than 120 member States (both OECD and non-OECD economies).The OECD's Global Forum conducts peer reviews to assess members' jurisdictions on their level of compliance with internationally agreed standards for the exchange of information.

The peer reviews are currently organised into phases as follows with regard to the exchange of information on request:

- **Phase 1:** this phase focuses on the legal and regulatory framework
- **Phase 2:** this phase focuses on the efficiency of the system in place
- **Phase 3:** this phase ensures continuous monitoring of implementation of the exchange of information (starting in 2016).

Following phases 1 and 2 of the peer reviews, members receive ratings on the availability of information, access to information and exchange of information, as well as an overall rating.

In 2011, Luxembourg successfully passed phase 1. As stated by the Luxembourg government, the assessment was carried out soon after the 2009 political decision to introduce the OECD standard provision on the exchange of information on request in double taxation treaties and the active period of time during which Luxembourg negotiated with many countries to include this provision in double taxation treaties.

In 2013[1], Luxembourg received a non-compliant assessment as an overall rating after phase 2. It should be noted that phase 2 covered the period from 2009 to 2011, which matched the setting up of the new standard concerning the exchange of information on request[2].

The first answer is in connection with the identification of owners of bearer shares. The other answers are in connection with an effective exchange of information for tax purposes with other States.

Mechanism to identify the owners of bearer shares

Shares of some companies (SA, SE, SCA) may be issued in bearer form. Under the previous regime, the holders of those shares were not identified in the register of shareholders of these companies.

The OECD's Global Forum concluded that: *"although there are parallel mechanisms that ensure the availability of the information in specific situations, there is no overall obligation to identify the holders of bearer shares under all circumstances".*

In line with the OECD expectations, Luxembourg proposed a new regime to ensure the availability of information relating to bearer securities holders[3].

The key points of this new regime as from August 2014 are:

- Bearer shares continue to exist. Entities, including investments funds, which have issued/will issue bearer shares will have to deposit them with a depository
- The depository should be a Luxembourg professional as listed in the law implementing the regime (credit institutions, qualified lawyers, chartered accountants, etc.)
- The evidence of their ownership will be established by registration in the share register kept by the depository

1 During the session held in Jakarta in November 2013, the OECD's Global Forum adopted ratings for the first 50 jurisdictions on their level of compliance with the internationally agreed standard for exchange of information

2 The law of 17 March 2010 implemented effectively in the Luxembourg legislation the new standard of exchange of information on request. Nevertheless, taking into account the period of time required to ratify a double taxation treaty, most of them entered into force as from 2011 (http://www.impotsdirects.public.lu/conventions/conv_vig/index.html)

3 Law of 28 July 2014 on immobilising bearer shares and bearer securities

- Management of the Luxembourg entities concerned may incur fines if it does not respect the new regime

As from the entry into force of the new regime in August 2014, existing bearer shares will be:

- Cancelled if not deposited within 18 months
- Subject to suspension of their voting rights and dividend rights attached if not deposited within 6 months

Implementation of the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters

On 29 May 2013, Luxembourg signed the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters. Currently, more than 60 countries have signed this mutual agreement[4] (more than 20 countries signed during 2013).

This convention will enter into force for Luxembourg on 1 November 2014.

The convention is a multilateral agreement designed to facilitate international co-operation and collection of taxes between States.

It provides for all possible forms of administrative co-operation between States Parties in the assessment and collection of taxes:

- Exchange of foreseeably relevant information for taxation purposes in three ways: on request, spontaneously and automatically
- Tax investigations, including participation in tax investigations abroad
- Assistance in recovery, including conservatory measures
- Service of documents

In connection with the automatic exchange of information, States Parties are not able to directly exchange information on the basis of this convention. Two or more States Parties will agree separately on what and how they will exchange automatically. The OECD is developing a common standard for automatic exchange of financial account information. On 21 July 2014, the OECD released the first edition of this common standard. Luxembourg is committed to implementing this global standard swiftly.

Double taxation treaties concluded by Luxembourg

Luxembourg continues to negotiate double taxation treaties including the OECD standard provision on exchange of information on request.

New Luxembourg legislation dealing with the procedure for the exchange of information on request

The OECD's Global Forum recommended, inter alia, that: *"Luxembourg should review its interpretation of the foreseeable relevance concept to conform with the standard. "Luxembourg should exercise its powers to compel production of information and apply sanctions as appropriate."*

4 *As mentioned in the OECD Information Brief on the Multilateral Convention (November 2013)* "the Convention was developed jointly by the OECD and the Council of Europe in 1988 and amended by Protocol in 2010. The Convention is the most comprehensive multilateral instrument available for all forms of tax cooperation to tackle tax evasion and avoidance, a top priority for all countries. The Convention was amended to respond to the call of the G20 at its April 2009 London Summit to align it to the international standard on exchange of information on request and to open it to all countries, in particular to ensure that developing countries could benefit from the new more transparent environment. The amended Convention was opened for signature on 1st June 2011. The Convention has now taken on increasing importance with the G20's recent call for automatic exchange of information to become the new international tax standard of exchange of information"

On 31 December 2013, the Luxembourg tax authorities issued a Circular providing the interpretation they will follow on some concepts relating to the exchange of information on request:

- The concept of 'information that is foreseeably relevant'[5]
- The principle of non–retroactivity[6]
- The non-selectivity of data to be provided to the Luxembourg tax authorities[7]

The Luxembourg tax authorities also stipulate in this Circular how they will request information depending on the residency of the person concerned[8].

This tax Circular is in line with the OECD's latest comments dated 17 July 2012 on how to interpret the provision on exchange of information on request.

Moreover, the Luxembourg government submitted to the parliament a draft bill on the procedure for the exchange of information on request[9].

The key points of the draft bill are the following:

- The procedure would apply to all requests for the exchange of information on request received from another jurisdiction under one of the various international tax agreements to which Luxembourg is stakeholder, such as a tax treaty, the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters (please see above) and laws transposing the 2010 European Directive on mutual assistance for recovery and the 2011 European Directive on administrative co-operation in the field of taxation (please see below)
- The Luxembourg tax authorities would be obligated to verify only whether a foreign jurisdiction's request is formally in line with the applicable treaty or law. If so, the Luxembourg tax authorities would execute the foreign request by sending an injunction notification to the data holder for the requested information. The foreign request would be viewed as confidential and could not be disclosed to the data holder
- The data holder would be obliged to provide the Luxembourg tax authorities with the information requested in its complete form, without alteration, within one month of the injunction notification. If a document to be provided contains data connected with a third party, such data should not be hidden. Failure to comply (refusal to provide information within one month or alteration of the information) could result in a penalty of up to €250,000

The Luxembourg government submitted to the parliament a draft bill on the procedure for the exchange of information on request[9]

5 The exchange of information should concern information that is foreseeably relevant ("vraisemblablement pertinents"). This is the limit to avoid the fishing expedition. Luxembourg mentions in the Circular that they will not reject a foreign State's request in case the likely relevant information can be examined following receipt of the information from the person concerned. Once the requesting State has given an explanation concerning the " foreseeably relevant" information requested, Luxembourg should not refuse a request or provide information requested because the Luxembourg authorities estimate that the information is irrelevant for the underlying examination or investigation

6 Double taxation treaties concluded by Luxembourg are often applicable as from 1 January of the calendar year following the year in which the Convention entered into force. However, the principle of non-retroactivity does not stand against the passing on of data from year(s) prior to the coming into force of the Convention, as long as the data to be passed on are relevant to determine taxable income in respect of the tax year covered by the Convention. Please note that the Circular refers to the applicable penalty in case of data holder's refusal to provide the requested information (a fine up to €250,000)

7 The data to be passed on to the Luxembourg tax authorities by the data holder, in order to comply with injunction decisions issued by the LTA following information requests from foreign tax authorities, must be provided in a complete form and with no alteration whatsoever. In case the data holder does not provide information requested in a complete form or alters the content of information to be provided, the Luxembourg tax authorities should impose a penalty up to €250,000

8 The tax circular targets three situations:

- *Should the person concerned is resident in Luxembourg, the Luxembourg authorities will send the request directly to this person*
- *Should the foreign tax authorities do not want the person concerned to be informed of the request, the request will be addressed directly to the data holder*
- *Should theperson concerned by the process is resident in Luxembourg but does not receive the request or he/she is non-resident in Luxembourg, the request will be addressed directly to the data holder*

9 Draft bill no. 6680

- The requested data would be able to include data from prior to the entry into force of an applicable treaty or law, provided that the requested data is foreseeably relevant in determining the income tax base for a year following the entry into force of the treaty or law

  In case of urgency or where the notification is likely to undermine the chance of success of an investigation conducted by the requesting jurisdiction, the Luxembourg competent authority would be able to prevent a data holder that is a credit institution, and its directors or employees, from disclosing the existence and contents of the injunction notification to the client or taxpayer concerned. Otherwise, the data holder could be subject to a penalty of up to €250,000.

- The procedural rules applicable before the courts would differ from the usual rules, to accelerate the treatment of requests for exchange of information on request (i.e. the period of time to file a claim before the court would be shorter, judges would be required to issue a decision in a specific timeframe, etc.).

The Luxembourg parliament must now review, discuss and, if necessary, modify this draft law before it can be approved.

2. Luxembourg's action in connection with FATCA

On 28 March 2014, Luxembourg and the United States signed a Model I FATCA Intergovernmental Agreement (IGA) (IGA type 1 is based on reciprocity and automatic exchange of information) and a Memorandum of Understanding (MOU) to improve international tax compliance between both jurisdictions.

This agreement will be followed by a procedure of Parliament approval in Luxembourg in the last quarter of 2014 before being transposed into local legislation.

On the basis of this agreement, the U.S. and Luxembourg tax authorities will automatically exchange information on assets of (I) U.S. citizens and (II) residents of the U.S. held by financial institutions in Luxembourg.

Based on article 3 of the IGA (Time and Manner of Exchange of Information), the information will be exchanged by Luxembourg within nine months of the end of the calendar year to which the information relates.

Following the Luxembourg government communication, the first exchange of information is planned before September 2015 applying to the financial year 2014[10].

The Foreign Account Tax Compliance Act (FATCA) obligation should also be detailed in:

- A Circular to be issued by the Luxembourg tax authorities
- Professional guidelines. The Association of the Luxembourg Fund Industry (ALFI) has already published a Q&A document on its website. The Luxembourg Bankers' Association (ABBL) has issued guidance notes

3. Luxembourg's actions at the European level

At the European level, the actions are in connection with the European Directive on administrative co-operation and the European Savings Directive.

European Directive 2011/16/EU on administrative co-operation in the field of taxation

EU Directive 2011/16/EU aims to strengthen tax co-operation between EU member states and organise the three methods for exchanging information (upon request, automatically and spontaneously).

The Luxembourg law of 29 March 2013, transposing EU Directive 2011/16/EU, introduced the exchange of information upon request and the spontaneous exchange of information as from 1 January 2013.

The Luxembourg law of 26 March 2014 transposed the remaining portion of EU Directive 2011/16/EU in connection with the automatic exchange of information between EU member states on specific types of income[11].

On the basis of this legislation, as from 2015 and for tax periods beginning 1 January 2014[12], Luxembourg will automatically provide information on three types of income: salaries, directors' fees and pensions and annuities.

In June 2013, the European Commission proposed to extend the scope of the exchange of automatic information under this Directive to additional types of income (dividends, capital gains, royalties, etc.). This is still a proposal waiting for the political consent of all EU member states. Nevertheless, taking into account the current position on the Savings Directive (see below), the scope of this Directive could be extended in the near future.

> Currently, 26 member states exchange information automatically under the EUSD Directive

European Savings Directive

The EU Savings Directive (EUSD), which has been applicable since July 2005, requires EU member states to exchange information automatically about interest payments made by paying agents located in one EU member state to individual recipients (and to specific types of entities, called 'residual entities') resident in another member state.

Currently, 26 member states exchange information automatically under the Directive. Two member states—Austria and Luxembourg—still apply a 35% interest withholding tax as an alternative to the automatic exchange of information (unless the beneficial owner of the payment requests the paying agent to exchange information automatically in lieu of the withholding tax). Several 'third countries' (such as Switzerland) and 'dependent and associated territories' (such as the British Virgin Islands, Cayman Islands and Channel Islands) apply similar or equivalent measures (i.e. an interest withholding tax or automatic exchange of information measures).

10 Answer of the Luxembourg Finance Minister of 28 July 2014 to the parliamentary question n°378

11 Five types of income are concerned: (I) salaries, (II) directors' fees, (III) pensions and annuities,(IV) ownership of and income from immovable property, and (V) life insurance products not covered by other EU legal instruments on exchange of information and other similar measures
The EU Directive requires each EU Member State to select income on which the State will automatically exchange information with other EU Member States

12 The exchange of information will be performed on a regular basis (i.e. at least once a year). Luxembourg commits to provide information for any given year by 30 June of the following year at the latest. For example, for information concerning fiscal year 2014, information would be provided by or before 30 June 2015

An amended version of the EUSD has been in the EU legislative pipeline since 2008 (and adopted by the EU Council on 24 March 2014). The amendments aim to close loopholes identified under the current Directive. In order to maintain the level playing field between the EU member states and the ‘third countries’ (Andorra, Liechtenstein, Monaco, San Marino and Switzerland) that have implemented equivalent measures to the current Directive), the EU Commission has requested that these five countries update their agreements with the EU to reflect the revised scope of the amended Savings Directive and to commit to implement, as early adopters, the new single global standard for the automatic exchange of information developed by the OECD and endorsed by the G20.

Luxembourg announced in 2013 that it will unilaterally move from imposing the 35% interest withholding tax to automatically exchanging information for EUSD purposes from 1 January 2015.

Luxembourg will automatically exchange information with other EU member states on interest (as defined in the currently applicable EUSD) paid to individuals and residual entities with a permanent address in the EU, and with those dependent and associated territories having reciprocity clauses in their bilateral savings taxation agreements concluded with Luxembourg.

On 18 March 2014, the Luxembourg government submitted to parliament a draft bill to implement the necessary changes into Luxembourg tax law[13]. The first exchange of information due date under the draft bill is 20 March 2016 regarding calendar year 2015.

On 20 March 2014, Luxembourg and Austria dropped their opposition to the adoption of the amended EUSD (as sufficient guarantees were provided as to maintaining the level playing field with the above-mentioned third countries). As mentioned above, the amended Directive was adopted by the European Council on 24 March 2014 and includes the following changes to the current Directive:

- All types of regulated investment funds investing in debt claims will be covered by the Directive. In practice, this means that non-UCITS (part II) SICAV, SIF-SICAV and SICAR funds will fall within the scope of the Directive
- Certain life insurance products will be covered (such as certain unit-linked life insurance contracts), subject to grandfathering rules for contracts subscribed before 1 July 2014
- The definition of residual entities will be extended to include all EU entities that are not subject to effective taxation (the definition under the existing Directive is more restrictive). In practice, payments made to a broader range of entities, trusts, foundations and similar legal arrangements within the EU will become reportable (such as payments to a German KG, UK LP, Dutch Stichting and trusts in several member states)
- Look-through rules will apply to payments made to blacklisted entities, trusts, foundations and similar legal arrangements outside the EU (such as Bermuda trusts, Hong Kong private limited companies, Panama foundations, etc.)

EU member states must transpose the amended EUSD into their domestic law before 1 January 2016, and it will apply as from 1 January 2017.

Luxembourg development regarding the EUSD are linked to the adoption of the automatic exchange of information as a new standard at the G20 level, and also to other initiatives such as FATCA, the EU mutual assistance directive on administrative cooperation, the OECD Convention on Mutual Administrative Assistance in Tax Matters and the corresponding common reporting standard on automatic exchange of information.

13 Draft bill no. 6668

Spain

Tax update

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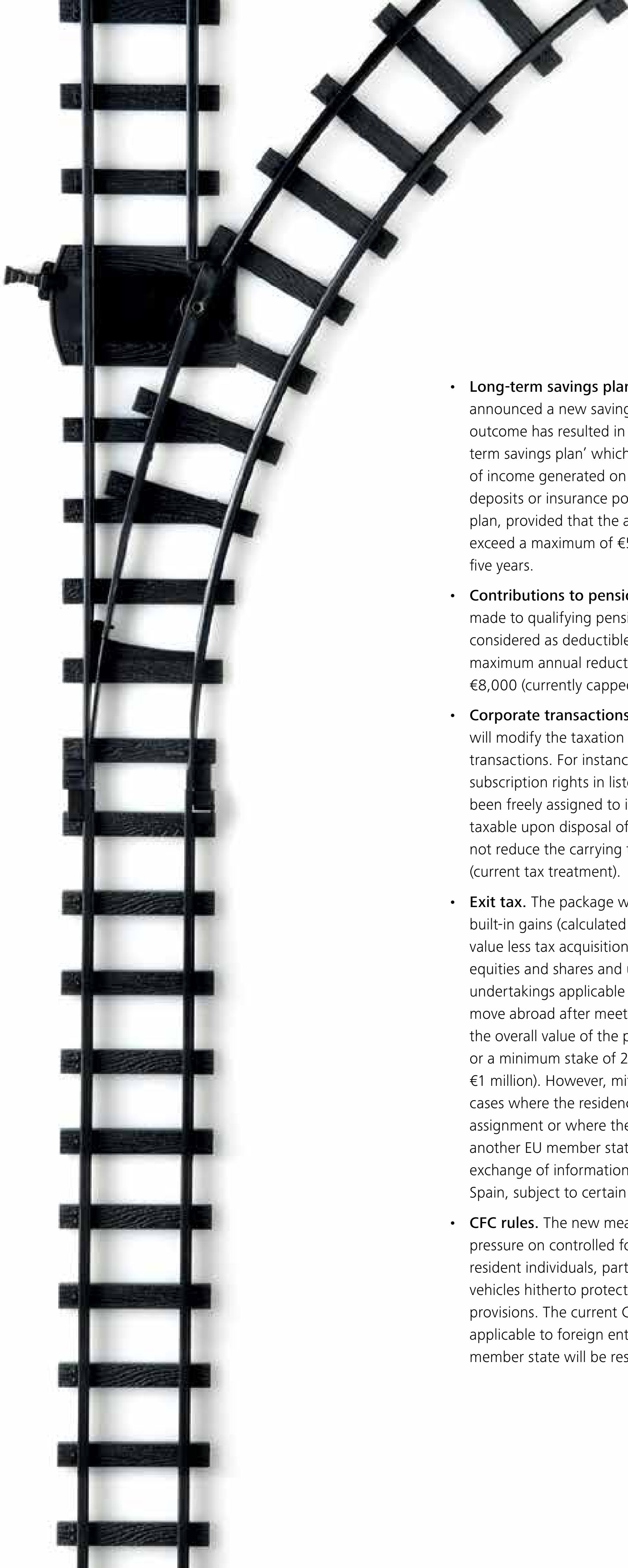
In June 2014, the Spanish government unveiled a draft tax package that has been presented to the parliament in August 2014. The tax package is expected to set the tone for a major reform of the Spanish tax system, which is currently limited to direct taxes. In this respect, the announced changes refer mainly to Personal Income Tax (PIT) and Corporate Income Tax (CIT), but there are also measures aimed at promoting and improving tax compliance.

Most of the proposed tax changes will be effective as of 1 January 2015, although there are certain transitional measures and exceptions. There is currently a certain level of uncertainty on whether all the draft measures will be eventually passed into law, since subsequent amendments may be introduced by parliament. There is, however, a reasonable expectation that a number of the announced measures will be introduced in a similar form as that presented in the current draft.

We summarise below some of the proposed measures that we believe may be of relevance for the asset management industry, focusing on investors subject to PIT:

- **Tax rates.** The current basic structure of PIT will be maintained and a 'dual tax base' will apply with different tax rates applicable to the 'general tax base' and to the 'savings income tax base'. The top rate applicable to the 'general tax base' will fall from 52% to 47% for 2015 and to 45% for 2016. However, the income threshold to reach the new marginal maximum will be significantly lower (cut from €175,000 to €60,000). The savings income tax rate will be reduced from 27% to 24% in 2015 and subsequently to 23% in 2016. Additionally, the savings income top threshold will be increased (from €24,000 to €50,000).
- **Short-term capital gains.** Under the current law, capital gains derived from the sale of an asset generated in one year or less must be computed in the 'general tax base' and subject to the top marginal rate according to the applicable scale, whereas only capital gains derived from the sale of assets held for more than one year can be included in the 'savings tax base'. The draft tax package changes this rule and as of 1 January 2015 capital gains and losses will be included in the savings tax base regardless of the holding period of the asset.
- **Income/loss setoff.** The proposed reform will introduce some flexibility in the rules applicable to the offsetting of interest income and capital gains/losses included in the savings part of the taxable base, allowing the setoff of income/losses derived from bonds and other income-producing assets with gains/losses derived from investment in shares and participations in equities and investment funds, subject to certain rules.
- **Dividend threshold exemption.** The new regulation will eliminate the currently applicable exemption to dividends obtained up to a threshold of €1,500. Since under current regulations the dividend exemption is not applicable to distributions made by investment funds, the tax reform will result in the same tax treatment of dividends paid by corporations and by investment funds (i.e. neither of them will be exempt after suppression of the threshold).
- **Capital gain reductions on assets held before 1994.** The tax reform will eliminate the time-based reduction coefficients applicable to capital gains derived from disposals of assets acquired before 1994. These reduction coefficients apply as a result of transitional measures that are still in force and allow for reductions in the amount of taxable capital gains derived from certain long-term held assets. The measure will be in force for disposals made as of 1 January 2015, so according to the published draft, capital gains made during 2014 may still qualify for the reductions under the old regime.



- **Long-term savings plan.** The government had announced a new savings accumulation vehicle. The outcome has resulted in a product called the 'long-term savings plan' which provides for an exemption of income generated on amounts invested in bank deposits or insurance policies that are linked to the plan, provided that the amounts contributed do not exceed a maximum of €5,000 per annum for at least five years.
- **Contributions to pension plans.** Contributions made to qualifying pension plans will still be considered as deductible allowances, but the maximum annual reduction will be capped at €8,000 (currently capped at €10,000 per annum).
- **Corporate transactions.** The new measures will modify the taxation of certain corporate transactions. For instance, the sale of preferential subscription rights in listed companies that have been freely assigned to investors will become taxable upon disposal of the rights and therefore will not reduce the carrying tax cost of the investment (current tax treatment).
- **Exit tax.** The package will impose an exit tax on built-in gains (calculated by reference to market value less tax acquisition cost) on holdings of equities and shares and units in collective investment undertakings applicable to resident individuals who move abroad after meeting certain conditions (e.g. the overall value of the portfolio exceeds €4 million or a minimum stake of 25% plus market value above €1 million). However, mitigation is provided for cases where the residence change is due to a work assignment or where the residence is changed to another EU member state or state with effective exchange of information measures in place with Spain, subject to certain requirements.
- **CFC rules.** The new measures will increase the pressure on controlled foreign entities held by resident individuals, particularly in certain EU-based vehicles hitherto protected under safe harbour provisions. The current CFC safe harbour exclusion applicable to foreign entities set up in another EU member state will be restricted by the reform.

The CFC exclusion will require not only that the foreign entity has been set up for valid business purposes (this requirement is already applicable), but also that the foreign entity is engaged in active business activities. There is a concern that controversy may arise over whether some private investment vehicles set up in other EU countries may now be caught under CFC anti-avoidance measures.

A safe harbour rule will grandfather collective investment undertakings that are within the scope of Directive 2009/65/EC of the European Parliament and of the Council (unless set up in a tax heaven).
A safe harbour rule will grandfather collective investment undertakings that are within the scope of Directive 2009/65/EC of the European Parliament and of the Council (unless set up in a tax haven).

- **Tax deferral regime for gains derived from qualifying funds.** Last but not least, the reform will maintain the basic tax rules applicable to Spanish resident individuals investing in resident funds as well as in EU-based undertakings with UCITS status, including the tax deferral regime in case of reinvestment of qualifying gains (known as the 'traspaso' system).

This means that, in the case of the final investor who holds shares or units in harmonised UCITS funds registered for distribution in Spain but deposited in a foreign custody account, the wording of the applicable new regulations on 'traspasos' will be the same as that recently analysed by the Spanish General Directorate of Taxes in ruling V1196-14 of 29 April. This ruling is of significant relevance for foreign asset managers and private banking clients holding assets deposited in custodial accounts outside Spain.

While the ruling recognises that holding assets in custodial accounts outside Spain is not a fact that by itself disallows the potential application of the tax deferral system in Spain, the Spanish tax authorities have set out quite strict requirements in order to apply the deferral regime in this particular context. This places significant importance on the procedures to subscribe/acquire and reimburse/sell the participations of shares and on the role of the Spanish entity acting as distributor of the funds, given that the latter plays a key role in reporting the relevant tax information to the Spanish tax authorities as required by the tax deferral system.

Broadly speaking, the Spanish tax authorities require that the final investor must pass the orders directly to the Spanish distributor. They also require that the Spanish distributor plays a principal, necessary and exclusive role in the transactions with the shares or units in scope. This role must be documented contractually. In order to prevent potential practical loopholes or gaps in the application of the deferral system, the procedure must be designed in a way that makes it impossible to subscribe or transfer the relevant shares without the distributor's involvement and also takes into account special situations such as termination of activity.

The new regulation will eliminate the currently applicable exemption to dividends obtained up to a threshold of €1,500

Foreign banks and asset managers wishing to offer the tax deferral system to Spanish resident clients with assets held in custodial accounts outside Spain are advised to review their current operational procedures and identify whether they are able to structure alternative operational procedures with a Spanish distributor that is compliant with the requirements set by the Spanish tax authorities.

Other relevant highlights are the following:

- The CIT rate will fall from 30% to 28% in 2015 and 25% in 2016. A new Corporate Income Tax Law will be enacted with significant changes in respect of current legislation.
- Wealth Tax and Inheritance Tax are not included in the announced tax package, although they are expected to be included in a broader reform of the tax system (still pending broader political agreement).