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International Tax

Spain Tax Alert

6 November 2015

Changes to patent box will bring the regime in line with OECD nexus approach

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Spain's 2016 finance bill, which received parliamentary approval via Law 48/2015 of 29 October 2015, includes amendments to the patent box regime to bring the current rules in line with the "nexus approach" endorsed in the OECD final report on action 5 (countering harmful tax practices more effectively, taking into account transparency and substance) of the base erosion and profit shifting (BEPS) project (for prior coverage of the final report on action 5, see the tax alert dated 8 October 2015). The nexus approach allows a taxpayer to benefit from an intellectual property (IP) regime (such as a patent box) only to the extent the taxpayer itself incurred qualifying expenditure that gave rise to the IP income.

Spain's patent box, which has been in effect since 2008, is designed to encourage the development of IP in the country. Under the regime, 60% of net qualifying income derived from the licensing or the transfer of certain intangible assets is exempt from corporate income tax in Spain, with the remaining 40% subject to the normal corporate income tax rate of 28% (reducing to 25% as from 2016).

Under the new rules, the 60% exemption will continue to apply to income derived from the licensing or transfer of qualifying IP, and the mechanics and requirements for the exemption essentially will remain unchanged (for example, the licensee must not be resident in a low-tax or tax haven jurisdiction and must utilize the license for a business activity that does not generate tax-deductible expenses for the licensor, unless the licensor and licensee are unrelated parties). However, a newly introduced ratio may limit or eliminate the benefits available under the regime in situations where the taxpayer has not created the relevant intangible asset itself (through its own resources or through subcontracting work to unrelated third parties).

The ratio is the lower of 1 or the result of applying the following formula:

- 130% of expenses (other than financing expenses and depreciation of buildings) incurred by the taxpayer that are directly connected to the creation or development of the relevant intangible asset, including expenses incurred as a result of outsourcing to unrelated third parties, divided by

- 100% of expenses (other than financing expenses and depreciation of buildings) incurred by the taxpayer that are directly connected to the creation or development of the relevant intangible asset, including expenses incurred as a result of outsourcing to related or unrelated parties, and expenses incurred for the acquisition of the intangible asset.

The tax exemption will be the result of multiplying the ratio described above by 60%. Therefore, if the ratio is 1, there will be a full 60% tax exemption; if the ratio is lower than 1, the exemption will be reduced accordingly.

For the exemption to be available with respect to gains from the transfer of qualifying intangible assets, the transferee may not be a related party.

The new rules generally will apply as from 1 July 2016, although a transitional elective regime will be available:

- If the intangible asset was licensed before 29 September 2013 (the effective date of previous amendments to the patent box regime (for prior coverage, see the *World Tax Advisor* article dated 8 November 2013)), the taxpayer will be able to elect to apply the rules in effect before that date.
- If the intangible asset was licensed on or after 29 September 2013 and before 1 July 2016, or if the asset is transferred before 30 June 2021 (the date set in the OECD report by which all existing IP regimes that are inconsistent with the nexus approach must be closed), the taxpayer may elect to apply the rules in effect before 1 July 2016, rather than the new rules.

An election to apply earlier rules under the transition regime will have effect only until 30 June 2021. As from that date, the new rules will apply. Taxpayers currently benefiting from Spain’s patent box regime should analyze the impact of the new rules to determine whether or not they should elect to remain subject to earlier rules.