New tax measures in Spain to reduce the public deficit (December 2016)

Tax Alert | December 2016

Spain's new government has updated the macroeconomic outlook for the country for 2017-2019, with the dual aim of following through on its commitment to the European Union in order to shore up public finances and cut the public deficit and laying the groundwork for the preparation of the 2017 State Budget.

Against this backdrop, the Government has announced that **three legal instruments are to be used to launch its first package of tax measures**, subject to agreement with the other political parties. Namely:

I. **ROYAL DECREE-LAW:** First of all, at the Cabinet meeting of 2 December 2016, the Government approved Royal Decree-Law 3/2016 of 2 December 2016, adopting tax-related measures aimed at consolidating public finances and other urgent welfare measures (RD-Law 3/2016 or the RD-Law).

   In order to ensure it enters into force without delay and is rubber-stamped by parliament (with the aim of doing so this December), this RD-Law will have to be the result of cross-party consensus.

   Tax measures make up the lion's share of the law's provisions, which can essentially be summarised as follows:

   1) While the overall **Corporate Income Tax** (CIT) structure remains unchanged as regards the reforms enacted in 2015, provision is made for certain ad-hoc measures seeking to boost the tax collected from large companies, essentially concerning the deferral of tax credits and the broadening of the tax base.

      In general terms, such measures can be summed up as follows:

      I. New limits on the offset of tax losses by large companies

      With effect in tax periods commencing as from 1 January 2016, the restrictions on the offset of tax losses (NOLs) from previous years have been widened. This measure applies exclusively to **large companies**, meaning those with a net revenue of at least €20 million at the start of the relevant tax period.

- Companies with a **net revenue of €60 million or more may only offset 25%** of their tax base, prior to the capitalisation reserve.

- **This threshold stands at 50%** for companies whose net **revenue falls between €20 and €60 million**.

The same restrictions apply to the reversion of deferred tax assets provided for in article 11.12 of the CIT Law.

There are, in turn, certain exceptions to this special rule, e.g., it does not apply where NOLs fall below €1 million, or where an entity is extinguished without being subject to the tax neutrality regime, or with respect to income derived from arrangement with creditors, while also excluding the portion of the tax base corresponding to a reversal in the form of computable income of deducted impairment losses deriving from a stake in the share capital of entities generated in tax periods commencing prior to 1 January 2013, provided certain conditions are met.

As far as the **tax regime governing cooperatives** is concerned, such measures are identical, albeit adapted in order to cater to their particular features as regards the offset of tax quota rather than the tax base.

II. Overall limit on double taxation tax credits

With effect in tax periods commencing as from 1 January 2016, provision is made for a new **limit on the use of double taxation tax credits**, set at **50% of the tax quota**.

Thus, juridical and economic double taxation credits (articles 31 and 32 of the CIT Law, respectively) may only be taken to reduce tax quota by up to 50%, and any unused portion may be taken in future tax years, on the same terms and conditions and without any time limit.

III. Reversal of impairment losses on shares prior to 2013

Transitional Provision Sixteen of the CIT Law has been amended **with effect as from tax periods commencing from 1 January onwards**.

This highly specific measure will affect large or small enterprises liable for CIT that still recognise (without any reversal in 2016) impairment losses on shares in entities that were tax deductible up to and including tax periods commencing in 2012.

Note that such impairment losses were no longer tax deductible for tax periods commencing as from 1 January 2013, whether the relevant shares were in Spanish or foreign-resident entities, and regardless of whether such entities were listed or otherwise.

The new development takes the form of a new **mechanism for reversing** such tax losses, by including the above previously deducted impairment losses as taxable income in respect of a minimum amount, notwithstanding any larger reversals as may apply under the general rules, which remain unchanged. The above minimum amount will be one fifth of the temporary difference pending reversal, over the first five tax periods commencing as from 1 January 2016. In other words, the RD-Law accelerates the reversal of such temporary differences, thereby obliging all affected companies to reverse them on a straight-line basis in 2016-2020.

Specifically, such integration must at all times be carried out in the tax period in which the share was transferred.

IV. Broadening of the exemption on securities representing the equity of entities and permanent establishments to include losses

The RD-Law modifies the exemption regime governing dividends and the proceeds from a disposal of shares (article 21 of the CIT Law), albeit maintaining the core structure of this key tax mechanism (set in place in 2015), one of the central pillars of CIT. All of the foregoing **with effect as from tax periods commencing on 1 January 2017 and thereafter**.

While this is a complex area, the key new developments can be broken down as follows:

- The main one is the new non-deductible status of losses arising on share transfers, i.e., extending the exemption rule in three scenarios:
  - In scenarios triggering the right to the exemption for income per article 21.3 of the CIT Law, although the requirement as regards the percentage or acquisition value of the stake may be met at any time during the calendar year prior to the date on which the transfer takes place.
  - Even in the case of stakes of less than 5% or an acquisition value of €20 million or less (and which are not therefore eligible for the exemption), where they correspond to non-resident entities which, in the period in which the transfer took place, were not subject to and not exempt from a corporate income tax with a nominal rate of at least 10%, or are not tax resident in a country with a double taxation treaty containing an exchange of information clause.
  - In any event, where they are entities tax resident in a tax haven, save where they reside in the EU and have been formed and operate in line with valid economic reasons and pursue economic activities.
- Nonetheless, the deductible nature of any losses generated is recognised in the event of the extinguishment of the investee (provided such circumstance is not due to a restructuring transaction). In such case, the losses fall outside the exemption rule, albeit reduced by the amount exempt or subject to a tax credit in respect of dividends or shares in profits received in the preceding 10 years, provided such circumstance has not reduced the acquisition value.

Finally, a brief aside with respect to the regulations governing the exemption on income earned abroad via permanent establishments qualifying for such purposes (taxation of at least 10% and non-residence in a tax haven). In this regard, the RD-Law introduces the exemption on losses deriving from the transfer of such permanent establishment, in line with the above with respect to stakes in entities. Moreover, in the event of a cessation of activity at the permanent establishment, income may be

exempt, while losses may in contrast be deductible, albeit reduced by any amounts enjoyed under an exemption or credit with respect to prior income.

2) Amendment of Law 11/2009 of 26 October 2009, regulating Spanish Real Estate Investment Trust (**REIT**).

As from tax periods commencing on 1 January 2017 onwards, the treatment of income earned on the transfer or redemption of shares in the share capital of companies applying the special REIT tax regime has been modified. Thus, where the transferor or transferee is a taxpayer liable for CIT or Non-Resident Income Tax (NRIT) with a permanent establishment, the exemption envisaged in article 21 of the CIT Law will no longer apply, albeit (and this is the new development) solely with respect to any profits made. With this in mind losses will not be included within the tax base.

3) Renewal of **Wealth Tax** for 2017.

The RD-Law extends this tax to include 2017, thereby postponing the elimination of the charge in the form of a 100% rebate of any tax due until tax periods commencing as from 1 January 2018.

Thus, as in previous years, it will fall to the autonomous community authorities to decide on how this tax is to be structured in 2017, even taking in a total or partial rebate, as was the case in the Madrid Autonomous Region in 2016. .

4) Amendments to the General Taxation Law in order to restrict **instalment payments and deferrals** of tax debts.

Entering into force in 1 January 2017, the following measures have been adopted in a bid to tighten the requirements for the deferral or instalment payment of tax debts:

- The tax obligations to be met by taxpayers obliged to make **withholdings and payments on account or CIT pre-payments**, or with respect to **charged tax** (*tributos repercutidos*) -e.g., VAT-, save where it can be duly evidenced that the tax charged has not effectively been paid.

- The **enforcement of tax settlements, totally or partially upheld under a final decision, which would previously have been suspended** during the processing of the relevant administrative appeal or the economic-administrative claim.

Moreover, payment of tax debts in kind are not possible where such debts are deemed non-deferrable in nature. .

5) Increase in special taxes (**tobacco and alcohol**).

The new developments essentially concern the Tax on Intermediate Products and the Tax on Spirits and Alcoholic Beverages, with a 5% increase to the tax levied on the consumption of intermediate products, spirits and alcoholic beverages, both on the mainland and in the Canary Islands.

As far as the Tax on Tobacco is concerned, the weighting of the specific component has been increased with respect to the ad valorem component.

Both increases have been in place **since 3 December 2016**.

6) Update of land registry values.

Article 32.2 of the Land Registry Law provides for the possibility of updating registered values in line with the General State Budget Law for each year.

As a result of the delay in forming a new government, it will not be possible to approve the draft 2017 Budget Law before the year is out and, given that Property Tax accrues on 1 January of each calendar year and in view of the pivotal role played by the registry value as regards the base of the above tax and, in short, the definitive tax payable, the government has included this measure in the RD-Law. This will help shore up municipal finances.

II. **ROYAL DECREE:** Second, with respect to matters within the purview of the government, 6 December 2016 saw the publication of Royal Decree 596/2016 of 2 December 2016. Pride of place goes to a major package of reforms concerning tax management and supervision with respect to Value Added Tax (VAT), centring on the **System for the Immediate Supply of Information** (known in Spanish as SII), set to affect large companies (estimated at around 62,000, accounting for 80% of annual turnover in Spain), and **entering into force on 1 July 2017**, although the information to be reported as from the above date dates back to 1 January 2017.

The SII is a new system for keeping VAT records via the Spanish Tax Agency website, in the form of an almost immediate supply of VAT books. This will bring about a radical shift in the way this tax is managed, from the standpoint of both the tax authorities and taxpayers, meaning that invoicing and record-keeping will have to be performed almost in real time, with the threat of further penalties in the event of error or infringement. On the other hand, it will enable information to be supplied immediately, the launch of tools to help prepare VAT returns, and will fast-track the authorities' inspection activities and help taxpayers detect any formal errors.

There is no doubt that the companies affected will have to get to work without delay on adapting their procedures and systems if they are to hit their targets by 1 July 2017.

- Parties obliged to use the SII: (i) on a mandatory basis, any large companies (those that file monthly returns) opting for the monthly VAT refund regime and entities opting for the special VAT groups regime; and (ii), voluntarily, any other taxpayer that chooses to do so.

- Deadlines for recording entries. Provision has been made for a general deadline falling four days as from the date on which an invoice is issued or accounted for, which may be extended to eight days in 2017 during the first six months in which the system applies (the second half of the year).

- The formal obligations on taxpayers opting for the SII are thus more straightforward, since they will no longer need to file annual summary return 390, form 340 or the annual declaration of transactions with third parties (form 347).

- Extension of the deadline for filing self-assessments. Monthly VAT returns must be filed during the first thirty calendar days of the month following the monthly settlement period (formerly 20 days), or by the last day in the

month of February (formerly by 20 February) in the case of the return for the month of January.

III. **FUTURE DRAFT LEGISLATION:** In order to round out the trio of legal instruments to be set in place, plans have been announced to put forward further **draft legislation approving other measures that will require parliamentary consensus**, spanning five areas:

1) **New tax on carbonated and sugar-based drinks**.

   With the aim of raising €200 million, while combating the risk of obesity entailed by the consumption of such drinks.

2) **€1,000-cap on cash payments**, down from the current figure of €2,500.

3) Less stringent regime as regards the **inclusion of tax debtors on the annual list of "persons in debt to the Public Treasury"**, removing those who have settled their debts after having been notified.

4) Plans have been unveiled for a draft law on **measures to combat tax fraud,** which looks set to be a key instrument for boosting public revenues.

5) Lastly, **wholesale changes to environmental taxation** have been announced for 2017.

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