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Spain

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Key developments affecting tax law and practice

Domestic law

During the most difficult years of the Spanish economic crisis, there was a significant decrease in the income collected through Corporate Income Tax, since the majority of Spanish-based companies were experiencing a significant reduction in profit, and some of them serious losses, which generated tax credits against the Spanish Treasury.

In addition, the former tax system encouraged Spanish companies to borrow money to benefit from a flexible tax regime on the deductibility of interest payments with no limitation.

Consequently, to revert the situation, Spanish Corporate Income Tax was profoundly amended, following these principles: (i) simplifying the provisions set out in the law in order to reduce tax litigation by including recent judicial and administrative resolutions; (ii) providing the tax system with legal certainty; (iii) reducing tax rates and abolishing tax allowances; and (iv) introducing legal measures oriented toward cash-repatriation (participation exemption) and measures to strengthen the equity of companies.

In our opinion, the most relevant developments of Corporate Income Tax in Spain, to be further analysed, are the following:

(i) New participation exemption regime on dividends and capital gains.
(ii) New tax horizontal consolidation regime.
(iii) Success of the Spanish SOCIMI (Spanish real estate investment funds).
(iv) Amendments to the rollover regime on company restructurings.
(v) Special measures focused on reducing the public deficit.
(vi) Introduction of the capitalisation reserve and other tax credits.

New participation exemption regime on dividends and capital gains

The new participation exemption regime was introduced in Spain with effect from 1 January 2015 and amended on 3 December 2016, following a resolution from the European Commission which focused on two main issues: (i) to give an equivalent treatment to dividends and capital gains arising from qualified resident and non-resident companies; and (ii) to set an exemption method to avoid double taxation in order to increase competitiveness and internationalisation of European companies.

Following the European Commission's resolution, Spain passed a participation exemption method for dividends and capital gains arising from qualified resident and non-resident companies. This participation exemption regime has eliminated the former imputation method to internal source dividends and capital gains, which will only now apply for internationally sourced dividends and capital gains.

Therefore, Spanish companies will be entitled to benefit from the participation exemption regime on qualifying resident and non-resident companies on the distribution of dividends and capital gains. In addition, Spanish companies with non-resident subsidiaries may choose to apply for the participation exemption regime or the imputation method deducting withholding tax in accordance with the applicable tax treaty provisions.

In order to qualify for the participation exemption regime, the following requirements should be met: (i) the shareholding in the subsidiary must be of at least 5% or, alternatively, it must have a minimum value of at least €20 million (participation requirement); and (ii) it has to be held uninterruptedly for at least one year (holding requirement). In this sense, the holding requirement might be met at the company group level.

In addition, if more than 70% of the subsidiary's income consists of dividends or capital gains deriving from other subsidiaries, it would be required that the holding meets the abovementioned participation and holding requirements in the indirectly controlled subsidiary. Nevertheless, the precedent rule would not be applicable if dividends have been included in the tax base of the directly or indirectly owned entity in entities not allowed to apply for an exemption scheme or a double taxation tax credit scheme.

This exemption also applies to foreign-source dividends and capital gains if the abovementioned participation and holding requirements are met and the subsidiary has been subject to (and not exempt from) a tax equivalent to Spanish Corporate Income Tax at a nominal rate of at least 10%. In this regard, the "*equivalent tax*" requirement will be met when the subsidiary is resident in a jurisdiction that has concluded a tax treaty with Spain which includes an exchange of information provision. Besides, the indirect shareholding requirement would also apply to foreign-source dividends and capital gains.

The exemption does not apply to dividends or capital gains deriving from the transfer of shares in entities with tax residence in a tax haven jurisdiction in accordance with the Spanish legislation.

Conversely, in order to apply symmetric treatment, tax losses derived from the transfer of qualified participations as defined above are not deductible. Capital losses derived from the sale of non-qualified participations may be deductible, but reduced by, if any, the amount of tax-exempt dividends received by the subsidiary since 2009 and by the amount of exempt gains recognised by a related-party seller in a previous transfer of the Spanish subsidiary.

Lastly, in case of foreign Permanent Establishments – PEs – (e.g. branches, etc.), the Spanish Head Office is not allowed to apply the participation exemption on profits generated by the PE until such profits do not exceed the amount of tax losses computed and deducted before 2013.

New horizontal tax consolidation regime

In line with several EU Court cases, effective from 1 January 2015 Spanish legislation extended the scope of the tax group in order to allow the application of the tax consolidation regime to the following cases:

- Spanish subsidiaries held indirectly through a foreign intermediary company can form part of the tax group.
- Horizontal tax consolidation is allowed in the sense that Spanish direct or indirect subsidiaries of a common foreign parent company are able to form a Spanish tax group.

Until that date, only Spanish entities directly participating with another Spanish entity were allowed to form part of a tax unity in Spain.

This amendment has enabled multinationals or private equity funds to revisit the corporate tax treatment of their portfolio of Spanish subsidiaries given that, according to the previous

law, when Spanish subsidiaries were commonly participating with a non-Spanish entity, they could not belong to the same tax group of companies. On the contrary, with the new regulations, Spanish entities with a common parent company can form part of a group of companies, irrespective of the country of residence of the parent company.

Special rules were envisaged for specific situations such as two or more already existing tax groups which, according to this new rule, must be integrated within a sole tax group.

Due to the vast variety of situations, this new rule generated considerable uncertainty in relation to the effects derived from (i) the creation of new tax unities, (ii) the extinction of previous tax groups, or (iii) the integration of several tax unities into a sole one. As a result, a relevant number of rulings of a binding nature were issued by the Spanish tax authorities during 2017.

New groups of companies may opt to be taxed on a consolidated basis if their election to operate under this regime is carried out before the beginning of the tax year in which the regime is going to be applied.

For applying the tax consolidated regime, several requirements must be met; amongst others: the dominant entity must hold directly or indirectly at least 75% of the dependent entity; such ownership must be maintained for the entire year of consolidation; the Spanish companies must not be subject to special regimes such as Temporary Business Alliances or be tax-exempt companies; and the companies must not be taxed at rate different than that of the parent company, etc.

Success of the Spanish SOCIMI

SOCIMIs were introduced in Spain on 26 October 2009. However, the earlier regime was not attractive for foreign investments and it was not until the latest amendments which took place in 2012 when the SOCIMIs started to be attractive for foreign investors.

SOCIMIs (also known as Spanish REITs) are Spanish listed companies whose main purpose is the acquisition and development of real estate of an urban nature for the purpose of renting or holding of shares in other SOCIMIs or foreign REITs.

In 2012, the Spanish government introduced several amendments to the legal and tax regime of SOCIMIs in order to attract foreign investment in Spain through this vehicle. The main feature of this regime is the SOCIMI 0% Corporate Income Tax rate if certain requirements are met, competing with other REITs in different jurisdictions.

This preferential tax regime for SOCIMIs partly relies on the shift of taxation from the SOCIMI to the investors, whose final taxation will depend on its legal form and its tax residence. Nevertheless, SOCIMIs will be taxed at 0%, provided the shareholders owning at least 5% of its capital are taxed on the dividends received at a minimum nominal tax rate of 10% ("*minimum taxation test*"). If the shareholders are entitled to apply for an exemption, or subject to a nominal tax rate of less than 10%, SOCIMIs will be taxed at a 19% tax rate on the dividends distributed to those qualified shareholders. It is important to clarify that this 19% tax rate will be paid by the SOCIMI and it will not be considered as a withholding tax on the dividends distributed.

As per the corporate requirements to apply for the special tax regime, the Spanish legislation requires SOCIMIs to have a minimum share capital of €5m, which must be fully paid-up and meet important investment requirements.

At least 80% of the value of the SOCIMI's assets must be invested in qualifying assets or shares and at least 80% of its income must derive from the rental income or dividends distributed by companies devoted to the rental of real estate.

However, there is no requirement with regards to the number of properties or shareholdings in companies, which in practice means a SOCIMI could apply for the special tax regime holding on property as long as it is held for a minimum period of three years. Nevertheless, the Spanish National Securities Market Commission establishes certain control over the launching of SOCIMIs with minor shareholders.

SOCIMIS are required to distribute at least 80% of their profits arising from real rental income and complementary activities, 50% of profits from the disposal of assets or shares and 100% of profits arising from qualifying shares.

Amendment to the rollover regime on company restructurings

The Spanish tax system foresees a special tax regime which allows the deference of both direct and indirect taxation arising from a restructuring transaction which has valid economic reasons. In line with the recommendations of the European Union, the aim of this regime is to eliminate tax barriers arising from mergers, spin offs, contributions of assets, swap of securities and other restructuring transactions.

With effect from 1 January 2015, this regime is expressly configured as the general regime to be applied to restructuring transactions. Previously, the Spanish rollover regime was applied only if the taxpayer decided on such. Although the rollover regime is currently applied by default, there is a general obligation to notify the Spanish Tax Authorities of the existence of a restructuring transaction which must respond to valid economic reasons to defer direct and indirect taxation derived from the disposal of assets.

The applicability of the rollover regime requires valid economic reasons for its application. If the taxpayer fails to prove valid economic reasons when applying this regime, the restructuring transaction would not qualify to apply for such regime. In this regard, one of the main amendments passed in 2015 was the reformulation of the legal consequences enforceable when the valid economic reason requirement was not met. The former regime foresaw that if the restructuring transaction did not qualify for the regime due to a lack of valid economic reasons, it triggered taxation for all capital gains arising from the transaction. Under the current regime, if the valid economic reason is not met, the legal consequence would be only to lose any tax advantage gained with the restructuring.

Special measures focused on reducing the public deficit

On 3 December 2016, Spain passed an urgent Royal Decree to introduce an important number of measures directed at reducing the public deficit and adjusting imbalances in the Spanish economy.

Measures contained in the Royal Decree have been designed to increase revenues by (i) eliminating the deduction of losses on investments in other companies and bringing forward the reversal of provisions recorded at an earlier date, and (ii) by placing limits on, and deferring, the use of net operation losses and double taxation credits.

The main tax measures are summarised below:

- Limits on the use of tax loss carry forwards. New limits to offset operating losses have been established depending on the net revenue of the taxpayer. In that sense, for large companies with net revenues equal to or above €20m in the first 12 months before the beginning of the taxable period, the following limits are laid down: (i) up to 50%, wherein the 12 months before the beginning date of the taxable period, the company's net revenues are equal to or above €20m but below €60m; and (ii) up to 25%, wherein the same 12-month period the company's net revenues are equal or to above €60m.
  For other companies, no amendments have been made. Consequently, the 70% limit remains for them.

- Limit on the use of domestic and international double taxation credits. For companies having net revenues equal to or above €20m in the 12 months before the beginning date of the taxable period, a limit has been placed on their use of domestic and international double taxation credits, whereby the aggregate amount of both types of credits that they use cannot exceed 50% of the gross payable for the year.
- The change in control rules for entities with a net operating loss was modified. The use of net operating losses of an acquired entity will be disallowed under certain circumstances, including (among others) where the acquired entity has been dormant in the past three months (currently, six months) or where, 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.
- Write-down of participations deducted before 2013 must be recaptured in a maximum period of five years commencing as of fiscal year 2016, or in a shorter period if the value of the portfolio is recovered in a shorter period of time, or if the participation is sold before the end of the five-year period.

Capitalisation reserve and other tax credits

Several tax credits have been abolished (including the environmental investment credit, the reinvestment credit and the profit investment credit) and will be replaced by a capitalisation reserve.

The capitalisation reserve aims to strengthen Spanish entities' net equity by keeping retained earnings undistributed in line with the principles inspiring the amendments to the Corporate Income Tax.

The capitalisation reserve will allow a tax deduction for 10% of the increase in net equity in a particular tax year, provided the company maintains the net equity increase during the following five years (except in the case of accounting losses) and must book a non-distributable reserve for the same amount. The deduction may not exceed 10% of the taxable base before the deduction, adjustments for deferred tax assets and the use of net operating losses. The excess may be carried forward for the following two years, subject to the applicable limit for each year.

Spain has never allowed the carry back of tax losses and this principle remains unchanged. However, with effect from 1 January 2015, Spain has created a new tax allowance consisting of a tax levelling reserve.

Thus, small and medium-sized companies (companies with a turnover in the previous tax year of below €10m) are allowed to deduct 10% of their taxable profits and allocate them to that special reserve. This reserve must be used to offset the losses incurred by the company within the five-year period following its creation. When this reserve is released, the tax deduction must be recaptured, diminishing, or even cancelling, the tax losses of that year. If during the five-year period the company does not incur any tax losses, the reserve must be released – and the tax deduction recaptured – at the end of the period. The deduction is limited to an annual limit of €1m.

BEPS

Spain has played an active role in the discussions on the BEPS Action Plan. In particular, the Spanish Tax Authorities have participated in several negotiations in international forums regarding the content and implementation of the BEPS programme, resulting in a package of 15 measures to be implemented in both European and domestic legislation.

As a result, and despite the fact that the BEPS Actions can be considered soft law – the OECD final reports on each action are legal recommendations to States – Spain has intended to transmute most of the BEPS Actions into domestic legislation.

In general terms, the majority of actions taken by Spain were reflected in the last reform of Corporate Income Tax in 2015, applicable with effect from 1 January 2015. In this sense, the most important amendments to Spanish domestic legislation are the following:

- Tax planning disclosure. Spain has not passed any specific regulation with regards to disclosure of tax planning strategies. However, Spanish-based companies are progressively winding down tax planning structures through low-tax jurisdictions mainly because of the negative publicity.
- List of tax havens. The Spanish tax system foresees an important number of anti-avoidance rules in relation to the use of "*tax havens*". The concept of "*tax haven*" is solely Spanish and it does not necessarily compare with other EU jurisdictions.
- Tax treaty abuse. Spain's current tax treaty policy is to negotiate the inclusion of limitation on benefits clauses.
- CFC rules. Before the implementation of the BEPS Actions, Spain already had important provisions in this regard. However, following the OECD recommendations, Spain has strengthened its CFC rules by making them more restrictive.
- Interest deductibility. Spain has already introduced a limitation on interest deductibility linked to the EBITDA with the company.
- Permanent establishments (PEs). Spain has not passed or amended any current law in this regard. However, the Spanish tax authorities have been applying a more economic approach to the PE definition.

Within the BEPS environment, the Spanish Government introduced for Spanish corporations to file the Country-by-Country Report for fiscal years commencing as of 1 January 2016.

Country-by-country reporting is required from:

- Entities resident in the Spanish territory that are the parent in a group, defined in the terms established in corporate tax law and which are not dependent on another resident or non-resident company, when the net business turnover of the group of persons or entities forming part of the group, in the 12 months prior to the start of the tax period, is at least €750 million.
- Entities resident in the Spanish territory, which are direct or indirect subsidiaries of a non-resident company in Spanish territory that is not, at the same time, a subsidiary of another, or permanent establishments of non-resident companies when, likewise, the net business turnover of the group of persons or entities that form part of the group, in the 12 months prior to the start of the tax period, is at least €750 million, provided that one of the following circumstances exists:
    - Entities designated by their non-resident parent entity to prepare this information.
    - There is no obligation for country-by-country reporting or similar as set forth in this section regarding the aforementioned non-resident entity in its country or the territory of its tax residence.
    - There is no agreement for automatic exchange of information, with regard to this information, with the country or territory in which this non-resident entity has its tax residence.
    - That, with the existence of an agreement for automatic exchange of information with regard to this information with the country or territory in which this entity

has its tax residence, there has been a systematic non-compliance of the same that has been notified by the Spanish tax agency to the subsidiary entities or to the permanent resident companies in Spanish territory.

However, country-by-country reporting will not be required by entities in the event that the country-by-country reporting has taken place through a subrogated parent country, complying with the conditions set forth in Council Directive 2016/881 of 25 May 2016.

Any entity resident in Spanish territory that forms part of a group obliged to carry out country-by-country reporting must notify the Tax Administration of the identification and the tax country or residence of the entity obliged to prepare this information. This notification must be made every year before the end of the tax period to which the information refers and must include the identification of the entity obliged to report it and whether this is carried out depending on the parent entity, obliged affiliate entity or subrogating entity.

Tax climate

In 2014, the Spanish economy started a period of continued growth, leaving behind numerous years of austerity. In 2017, Spain has continued consolidating the economic recovery, shown by approximately 3% of GDP growth. It means that, from 2014 to 2017, Spain has achieved a continued growth of approximately 3% per year, for an accumulated growth of 9.8% during the 2015–2017 period. After the Corporate Income Tax rate was decreased from 30% to 25% in 2015, the Tax Authorities have recently been reluctant to approve further Corporate Income Tax incentives other than the capitalisation reserves and other minor incentives analysed above. No changes to the corporate tax rate are expected.

In 2017, Spain remained active at an international level, negotiating or renegotiating Double Tax Agreements with Belarus, Cape Verde, Romania and Ukraine.

During 2017, the Tax Authorities toughened their campaign to increase control over fraud and the submerged economy. Amongst others, the tax audit campaign was focused on the review of high-net-worth individuals, the fraud of the digital economy and the tax elusion from multinational groups based on the risk areas foreseen by BEPS policies; in particular: the analysis of the aggressive tax planning structures; hybrid structures with different tax treatment in Spain *vs*. abroad; unnatural generation of financial expenses; abusive utilisation of transfer pricing policies; and taxation of transactions with entities resident in tax heavens, etc.

Developments affecting the attractiveness of Spain for holding companies

Holding companies

Spain offers a very attractive tax regime for holding companies with non-resident subsidiaries. In particular, this structure has been commonly set up to benefit from the important network of tax treaties between Spain and Latin American jurisdictions and its participation exemption regime.

Any Spanish entity may opt to apply for the ETVE regime ("*Entidad de Tenencia de Valores Extranjeros*" or "Foreign Securities Holding Company") as long as certain requirements are met.

Under this regime, ETVE companies will be entitled to apply for a full exemption on dividends and capital gains from foreign subsidiaries and no withholding tax would apply on the distribution from the ETVE company to its shareholders. In particular, the main benefits of this regime are:

(a) Full exemption applicable to dividends and capital gains obtained by the ETVE from its shareholding in non-resident subsidiaries.
(b) The non-Spanish taxation applicable to ETVE non-resident shareholders.

The main requirements to apply for this regime are as follows:

- The company's corporate purpose shall include the management and administration of foreign shareholdings through the appropriate human and material resources. However, the corporate purpose may also include other activities in Spain or overseas.
- The Spanish entity must hold a minimum participation of at least 5% either directly or indirectly in the foreign subsidiaries. This requirement may be replaced by an acquisition cost of the subsidiary's shares equal to or greater than €20m. In case of holding shares in a subsidiary acting as a holding company, its income should derive from more than 70% of dividends and capital gains, and the mentioned 5% participation has to be indirectly met by the Spanish entity in the lower-tier subsidiaries or, otherwise, certain other requirements must be met.
- The shareholding in which the minimum participation requirement has been met must have been held for at least one year prior to the date on which dividends and capital gains eligible for the participation exemption regime are received.
- In the case of dividends, this minimum holding period may be completed after the dividend distribution takes place. The period of time during which other members of the group have held the subsidiaries is also taken into account to calculate the holding period.
- Subject to tax test. Foreign subsidiaries held by a Spanish holding company must have been subject to an equal or similar tax to the Spanish Corporate Income Tax at a statutory rate of, at least, 10% (it is allowed for the effective tax rate to be lower due to the application of any reductions or allowances in the subsidiary). This test is considered to be met for subsidiaries resident in a country which has signed a Double Tax Treaty with Spain with an agreement on exchange of tax information. For capital gains purposes, this test has to be met during the entire holding period.
- The participation exemption will not apply in case the dividend distribution constitutes a tax-deductible expense in the subsidiary.
- The subsidiary cannot be resident in a Spanish listed tax haven unless the jurisdiction is within the EU and the taxpayer proves that it has been incorporated for sound business reasons and it performs an active business.

Any capital gains derived from the transfer of shares of the ETVE by non-resident shareholders, other than those that are tax haven-based or with a permanent establishment in Spain, will not be taxable in Spain provided the gain is derived from non-Spanish qualifying source income.

Finally, Royal Decree 2/2016, of 30 September, has introduced an amendment on the calculation of Corporate Income Tax instalments (or advanced payments) for companies with a turnover equal to or greater than €10m.

These advanced payments will be calculated in accordance with the profit and loss account of the company, which includes qualified dividends and capital gains. However, the company will be entitled to a refund of these payments when filing the Corporate Income Tax return.

Industry sector focus

Real estate. One of the symptoms of the Spanish economic recovery is the significant increase of real estate transfers and rentals. A large number of real estate transactions have taken place in 2017, following the trend of the last few years.

In line with this, in 2016 the Spanish Supreme Court ruled against the local Tax Authorities which subjected the transfer of urban real estate to Land Value Increased Tax even when the transferor did not obtain a capital gain from the transfer. The Spanish Constitutional Court confirmed the position of the Supreme Court in May 2017.

Tourism and leisure. As per its weight in the Spanish GDP, tourism and leisure remains one of the main economic sectors in Spain. In this regard, several regions in Spain are applying a tax on stays in tourist establishments, which has increased every year since its implementation. In addition, the Tax Authorities launched a specific plan to widen control over the taxation of online housing platforms.

Automotive, pharmaceuticals, life & science, engineering, R&D

The automotive industry is one of the key drivers of the Spanish economy, being one of the main employment-generating sectors. Its contribution to the Spanish GDP in 2016–2017 was around 12%, and production is growing every year in a very consistent manner, reaching, in 2017, the highest values ever recorded.

Due to the strong bet by the Spanish government on R&D incentives in connection with corporate taxes (i.e. R&D credit and the Patent Box regime), including generation of tax credits of between 25% and 42% of the R&D expenses and the possibility to monetise such tax credits up to an amount of €5m, several multinational groups have decided to locate their R&D activities in Spain. The pharmaceuticals, life & science and engineering industries are also amongst the most benefitting sectors from the R&D incentives.

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He has also extensive experience advising high-net-worth individuals, family business groups and large national and multinational business groups. He is an expert in tax audit procedures. He also advises on transfer pricing regulations (reorganisation of the value chain, litigation and master file documentation).

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