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Overview of corporate tax work over the last year

Types of corporate tax work

In the past few years, the Spanish market has experienced a growth in M&A transactions involving private equity (PE) funds, as well as a boost in real estate transactions. Favourable special regimes envisaged for real estate entities such as Spanish real estate investment trusts (SOCIMIs) and companies engaged in the rental of properties have contributed to the growth of companies within this sector.

Due to the COVID-19 pandemic, transactions and operations involving mergers, acquisitions, etc. came to a drastic halt in Spain – as in the rest of the world – and the recession has given rise to restructuring and refinancing transactions.

Higher health certainty (Spain has one of the highest vaccination ratios) coupled with increased mobility, a boost in private consumption and exports of tourism services are feeding economic recovery. The control of the pandemic, the utilisation of accumulated savings by households, momentum in the execution of Next Generation EU funds and a high productive capacity have compensated for the negative effects of the bottleneck caused by disruption in production chains and boost in energy prices.

Spanish tax authorities have significantly increased their scrutiny of the following areas:

(i) Tax audit proceedings of multinational groups, large companies and tax unities, with higher priority in companies less affected by the COVID-19 economic crisis. The main areas of performance are anti-tax avoidance measures, especially hybrid instruments, controlled foreign companies (CFCs), financial expense deduction and tax treaty abuse.

(ii) Control of tax and company groups.

(iii) The principal purpose test and effectiveness of substance requirements required by the Spanish anti-abuse regulations on non-resident entities recipient of payments derived from interest, royalties and dividends from Spanish entities, i.e. the business purpose test of non-resident entities benefitting from tax incentives derived from EU Directives or double taxation treaties.

(iv) In the field of transfer pricing within the scope of multinational corporate groups, the tax authorities are focusing on: (i) the review of the correct allocation of profits by Spanish entities according to the risks and functions assumed and performed, respectively, by the Spanish entity; (ii) recharacterisation of business models adopted by Spanish entities according to the real functions and risks; and (iii) determination of PE in Spain derived from the functions carried out by dependent commercial agents (e.g. substantial functions *vs* ancillary or auxiliary functions), etc.

(v) Taxation derived from operating via a company without their own means and resources by individual professionals due to the different rates for corporate tax and personal tax purposes.
(vi) Customs control has been strengthened for avoidance of tax fraud, as well as in relation to several sectors such as e-commerce and the digital economy.
(vii) The transposition of the Directive on Administrative Cooperation (DAC6) is focusing attention on those transactions that are subject to reporting under the DAC6 provisions.
(viii) In the field of VAT, the tax authorities have strengthened their control thanks to implemented systems and regimes such as the Immediate Supply of Information (SII) system, which means an in-time electronic supply of invoicing records through the tax authorities' website, which is mandatory for corporations.

Significant deals and themes

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 and allows 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). A non-distributable reserve for the same amount must be booked. 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.

Levelling reserve

Spain has never permitted the carry back of tax losses and this principle remains unchanged. However, since 1 January 2015, an allowance consisting of a tax levelling reserve has been applicable.

Thus, small and medium-sized companies (companies with a turnover in the previous tax year of below €10 million) 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 €1 million.

Professional entities

In recent years, professional entities have been a "hot topic" under the focus of the Spanish tax authorities. This is because it has become quite usual for individuals to interpose professional entities for the development of their professional activities.

In this regard, two main aspects are being considered by the Spanish tax authorities when subjecting the interposed professional entities to tax audits:
(i) First, a substance analysis is carried out in order to determine whether the referred entities have sufficient material and human resources to develop the corresponding activity and whether those resources used to provide the service really belong to the company or to the professionals themselves.
(ii) Secondly, it is analysed whether the professional entity carries out a real service.

It is worth bearing in mind that the tax authorities, when challenging the use of a professional entity, must use either the figure of the "sham of law" or the "conflict in the application of the tax law". Otherwise, the use of the professional entity would be triggered based on the arm's length principle applied to the relation between the professional and the entity.

The conflict in the application of the tax law requires that the realisation of the taxable event has been avoided by means of artificial transactions. On the other hand, in the sham of law figure, the existence of the professional entity itself is denied.

Thus, in the conflict of the application of the tax law, the business carried out is real; it is not a matter of hiding an act under the appearance of another, but of seeking protection or a more beneficial tax treatment in a legal provision that is not the one that properly corresponds to it.

The most recent precedents offer little clarification in relation to the application of these figures. It is necessary to examine each specific case, in order to determine which figure should be applicable.

Spanish tax authorities' improvement in tax controversies

The Spanish tax authorities have improved and increased the exchange of information between different public entities both at a national and an international level. In addition, there has been a relevant improvement regarding their tools to verify the tax compliance of the taxpayers.

Based on the above, in order to prevent and manage risks of tax audits and controversies, the following recommendations should be considered:

(i) An updated tax review (covering all the applicable taxes), as well as the correct tax planning regarding transactions and restructuring, should be performed.
(ii) To have an orderly accounting system and to keep all invoices and receipts that could be subject to tax authorities' requests.
(iii) All the disputed issues should be properly covered with sufficient evidence and legal arguments, taking into account the most recent precedents and resolutions.

Key developments affecting corporate tax law and practice

Domestic – cases and legislation

On 29 December 2021, the Spanish General Budget Law for 2022 was approved and published in the country's Official Gazette ("*Boletín Oficial del Estado*"). The General Budget Law introduced some relevant measures affecting both the taxation of companies and individuals.

In respect of corporate taxation, the most relevant measures contained in the above-mentioned General Budget Law are the following:

- *Minimum taxation*: taxpayers whose net turnover was at least €20 million during the 12 months prior to the date on which the tax period begins or taxpayers who are taxed under the tax consolidation regime will be subject to a minimum 15% tax.

  This means that a 15% tax will apply to the taxable base. However, this taxable base can be reduced by (i) the capitalisation reserve, and (ii) the reserve for investments in the Canary Islands.

  For newly created entities taxed at the rate of 15%, the minimum tax will be 10%, or 18% for credit institutions and entities engaged in exploration, research and exploitation of hydrocarbon deposits and underground storage of hydrocarbons.

When the taxpayer is entitled to apply (i) allowances, (ii) deductions for investments made by the port authorities, and/or (iii) deductions to avoid double taxation, the minimum tax liability will be calculated as follows:
- These allowances and deductions cannot reduce the net tax payable below the minimum tax payable.
- If the application of the allowances and deductions results in an amount greater than the minimum net tax liability, the remaining deductions shall be applied, with the limits applicable in each case, up to the amount of the minimum net tax liability.
- Special Canary Islands deductions will be applied respecting their own limits, even if the resulting net tax liability is less than the minimum net tax liability.

- *Special regime for the renting of dwellings in the corporate tax on corporate income tax: reduction of the allowance*. As for periods beginning on or after 1 January 2022, the applicable reduction on corporate income tax under the special tax regime for entities engaged in the rental of dwellings is reduced from 85% to 40%.

  In practice, this means that entities subject to this special regime will have an effective corporate income tax rate of 15%.

  Additionally, considering that the limit of 50% of the exemption to avoid double taxation (in the case of dividends or capital gains arising from income subject to the special regime) remains unchanged, this implies that the effective corporate income tax will be higher than the general tax rate (if we consider the taxation of the entity subject to the special regime and the shareholder together).

European – CJEU cases and EU law developments

On 30 December 2020, the Law for the transposition of DAC6 was published. DAC6 aims at transparency and fairness in taxation.

DAC6 implements Action 12 of the OECD BEPS Project. BEPS Action 12 provides recommendations for the design of rules to require taxpayers and advisors to disclose aggressive tax planning arrangements. These recommendations seek a balance between the need for early information on aggressive tax planning schemes with a requirement that disclosure is appropriately targeted, enforceable and avoids placing undue compliance burden on taxpayers.

In addition, in April 2021 the final regulation to complete the transposition of DAC6 was approved. Consequently, as of April 2021, the obligation to disclose cross-border mechanisms – to which any of the Hallmarks listed in Annex IV of Directive 2011/16/EU apply – is in force.

DAC6 applies to cross-border tax arrangements that meet one or more specified characteristics (Hallmarks), and which concern either more than one EU country, or an EU country and a non-EU country. It mandates a reporting obligation for these tax arrangements if in scope no matter whether the arrangement is justified according to national law.

Failure to comply with DAC6 could mean facing significant penalties under local regulations and reputational risks for businesses, individuals and intermediaries.

BEPS

Spain signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) on 7 June 2017 together with 67 other jurisdictions.

On 13 July 2018, the Spanish Council of Ministers approved the MLI as a starting point of the internal ratification process following which it will be deposited to bring the MLI into force for its covered tax treaties. Spain, by invoking article 35.7 of the MLI, decoupled the

date of effect of the MLI from the date of its entry into force. This reservation meant that the effects of MLI would not begin until Spain notified the MLI Depositary. It should be noted that the notification issued by Spain was received by the Depositary on 1 June 2022.

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. In this sense, the most important amendments to Spanish domestic legislation are the following:

- Tax planning disclosure (DAC6). In April 2021, Spain approved the regulation that fulfils the transposition of the measures included within Council Directive (EU) 2018/822 of 25 May 2018, as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements.
- 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 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 earnings before interest, taxes, depreciation, and amortisation (EBITDA) with the company.
- PEs. Spain has not passed or amended any current law in this regard. However, the Spanish tax authorities have been applying in practice a more economic approach to the PE definition, very close to the broader PE rule established within BEPS.

Within this environment, the Spanish government introduced for Spanish corporations the obligation to file a 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 the Spanish territory that is not, at the same time, a subsidiary of another, or PE 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 the 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 the 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.

VAT SII system

2018 was the first complete fiscal year of application of the SII system, according to which VAT taxpayers are required to file electronically and in real time the information related to invoices issued or received from their activity. Due to this system, the tax authorities have all the information related to the operations carried out by Spanish entities, meaning a strengthening of the existing electronic control systems in the hands of the tax authorities.

This special regime is mandatory for VAT taxpayers with a revenue exceeding €6 million, for VAT groups, and for taxpayers voluntarily applying the VAT monthly refund.

COVID tax implications

Due to COVID-19, the Spanish authorities published several rules aimed at alleviating the impact of the COVID-19 pandemic. Please find below the most relevant tax measures:

- Suspension of tax time periods.
- In general terms, the main measure adopted in the tax field was an adjusting of the deadlines for tax procedures. Significant exceptions include the obligation to self-assess taxes or file informative returns, which remain subject to the usual deadlines. In particular, the following deadlines for tax procedures are extended:
  - the time periods for payment of tax debts resulting from assessments issued by the authorities, both during the voluntary payment period and during the enforcement period; and
  - the expiry dates for time periods and split payments under deferred and split payment agreements that have already been granted.
- Guarantees were not enforced against real estate assets in administrative enforced collection proceedings.
- Deferral of tax debts.

Mandatory disclosure rules update

DAC6 – please refer to the "*European – CJEU cases and EU law developments*" section above.

Tax climate in Spain

The corporate income tax regulations underwent a sound reform in 2015 with the approval of a new corporate income tax law, which implied (i) a broadening of the taxable base derived from the elimination of certain tax allowances such as the portfolio impairment, (ii) a reduction of the tax rate from 30% to 25%, and (iii) the removal of most of the available tax credits. Since then, the government has 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.

However, as explained above, the General Budget Law for 2022 incorporated material modifications to Spanish tax legislation. In this respect, the most relevant amendments introduced by the General Budget Law refer to: (i) minimum corporate taxation; and (ii) reduction of the allowance under the special regime for the renting of dwellings in the corporate tax on corporate income tax. Together with the relevant amendments introduced for 2021, Spanish taxes have recently faced several modifications. The main amendments in 2021 were: (i) limitation to the participation exemption regime for dividends and capital gains; (ii) changes in the CFC regime; (iii) changes in the corporate income tax "exit tax" regime; (iv) an increase in the personal income tax rate applicable to high earners who are Spanish resident individuals; and (v) an increase in the net wealth tax rate applicable to net worth in excess of €10 million.

During the past few fiscal years, the Spanish tax authorities have toughened their campaign to increase control over fraud and the submerged economy, namely: special control on companies with net operative losses that have been generated repeatedly; more control over the shadow economy; special focus on related party transactions; the possible existence of permanent establishments and/or the attribution of profits, etc.; as well as the implementation of a new technology system that will allow taxpayers' representatives and advisors to interact with the tax inspection online.

Developments affecting 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 ("*Entidad de Tenencia de Valores Extranjeros*" or "Foreign Securities Holding Company") regime, as long as certain requirements are met.

Under this regime, ETVE companies will be entitled to apply for a participation exemption – limited to 95% as explained in the "*Key developments affecting corporate tax law and practice*" section above – 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) The 95% 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 €20 million. 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 must be indirectly met by the Spanish entity in the lower-tier subsidiaries or else 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 tax equal or similar to the Spanish corporate income tax at a statutory rate of at least 10% (it is permitted 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 that has signed a double tax treaty with Spain with an agreement on exchange of tax information. For capital gains purposes, this test must 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.

Industry sector focus

Real estate

One of the catalysts of Spanish economic recovery – prior to the COVID-19 pandemic – was the significant increase of real estate transfers and rentals. A large number of real estate transactions took place in 2019 and the first two months of 2020, following the trend of the last few years.

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, that SOCIMIs started to be attractive for foreign investors.

SOCIMIs, also known as Spanish real estate investment trusts (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 are 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 a withholding tax on the dividends distributed.

As per the corporate requirements to apply for the special tax regime, Spanish legislation requires SOCIMIs to have a minimum share capital of €5 million, 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 regard to the number of properties or shareholdings in companies, which means, in practice, that 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.

Automotive, pharmaceuticals, chemical, life sciences, engineering, and 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 Spanish GDP in 2016–2017 was around 12%, and its production continues to grow every year in a very consistent manner, reaching maximum historic values of production in 2017.

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 R&D expenses and the possibility to monetise such tax credits up to an amount of €5 million, several multinational groups have decided to allocate their R&D activities in Spain. The pharmaceutical, life sciences, chemical and engineering industries are also amongst the sectors to benefit most from R&D incentives.

2019 proved to be a highly active year for M&A as well as other corporate reorganisations derived from the Brexit effect. The clarity on the UK's future relationship with the EU has resulted in strategic transactions in order to carefully plan how to face the new UK market position.

The year ahead

In line with the approval of the General State Budget, it is expected that there will be continuous efforts by the Spanish government to increase the revenue from corporate

income tax, as discussed above in this chapter, by way of amendments to the corporate income tax law, or by way of tax review works primarily focused, for instance, on the field of transfer pricing for multinational entities.

In addition, it will be critical to see how the economy evolves following the severe COVID-19 recession in 2020 and 2021. In this sense, during 2020 and 2021, restructuring and refinancing operations increased at the expense of M&A transactions involving both PE funds and industrial corporations.

In this respect, we believe that the COVID-19 pandemic will lead to new market opportunities for the major players, which will help to reactivate the economy and, consequently, M&A transactions in the short and medium term.

As per international matters and as discussed above, Spain, by invoking article 35.7 of the MLI, decoupled the date of effect of the MLI from the date of its entry into force. This reservation meant that the effects of MLI would not begin until Spain notified the MLI Depositary and the counterparts of each tax treaty of the fulfilment of its internal procedures. The main advantage was that even when only one of the parties to the tax treaty had invoked the reservation, it would impact the effects for both parties. The notification issued by Spain was received by the Depositary on 1 June 2022. Accordingly, from now on, the provisions of the MLI will take effect in many tax treaties.

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