Spain approves major tax reform

December 23, 2014

In brief

The Spanish government, on November 27, 2014, passed Laws Nos. 26 and 27 amending the Personal Income Tax Law, the Nonresident Income Tax Law, and the Corporate Income Tax Law. The new provisions will generally come into force for tax years beginning on or after January 1, 2015.

While the amendments to the corporate income tax regime reduce the tax rate, they also introduce measures to limit the deductibility of certain costs and the use of net operating losses (NOLs). The amendments also introduce some measures in line with the OECD's base erosion and profit shifting (BEPS) project.

In detail

Corporate income tax

New corporate tax rate

The corporate income tax rate is reduced from 30% to 28% in 2015 and to 25% in 2016 and onwards. These rates also apply to Spanish permanent establishments (PEs) of nonresident companies.

Anti-hybrid rules

The amendment will introduce an anti-hybrid rule whereby a payment to a related party will not be deductible if, at the recipient level, it is either not treated as income or it is exempt or taxed at a nominal rate of less than 10%. Likewise, interest accrued under profit participating loans will no longer be deductible by the Spanish payor. Under the new tax rules, these instruments no longer follow the accounting treatment (debt) but the legal treatment (equity) to the extent that the financing is granted by a related party after June 2014.

NOLs

NOLs can be carried forward indefinitely but, for tax years starting in 2016, the annual offset is limited to the higher of 70% of the company's net taxable income or EUR 1 million. For 2015, the limitation continues at 50% of the company's net taxable income if its turnover in the previous tax year exceeded EUR 20 million.

Participation exemption

The participation exemption requirements have been slightly amended. A taxpayers meets the ownership test if it owns, directly or indirectly, at least 5% of the subsidiary's capital or the investment value in the first-tier subsidiary exceeds EUR 20 million (EUR 6 million in the previous legislation). When more than 70% of the first-tier subsidiary's income consists of dividends or capital gains from other subsidiaries, the taxpayer must indirectly meet the 5% ownership test in the lower-tier subsidiaries, unless (i) the first and lower-tier subsidiaries are part of the same corporate group, as defined under Spanish Commercial Law, and prepare consolidated financial statements, or (ii) the dividend or capital gain have not benefited from a participation exemption or foreign tax credit regime at the first or lower-tier subsidiaries. A subsidiary will now meet the subject-to-tax test if it is subject to a corporate income tax that is

similar to the Spanish one and its net taxable income is subject to a nominal rate of at least 10%. However, this requirement continues to be met when there is a tax treaty in force between Spain and the subsidiary's country of residence. Under the new rules and in line with the BEPS papers, dividends received by a Spanish company will not be entitled to the participation exemption when their distribution constitutes a deductible expense at the distributing company level.

The new tax rules eliminate the dividend received deduction for domestic dividends and subjects them to the same rules as the participation exemption rules for foreign-source dividends. Likewise, while capital gains on the sale of shares in a Spanish company was subject to tax, under the new rules those gains are, subject to a number of exceptions, generally subject to the same participation exemption rules as the sale of shares in nonresident entities.

Impairment losses & capitalization deduction

Fixed asset and real estate impairment losses will no longer be deductible. On the other hand, Spanish companies will be entitled to claim a tax deduction equal to 10% of the previous tax year's equity increase, provided that the company does not distribute that increase for at least five years. The tax deduction may not exceed 10% of the company's net taxable income, although amounts pending to be deducted can be carried forward 2 years.

Tax consolidation rules

Until now, consolidated tax groups required Spanish companies and PEs to be the controlling entity and all the controlled members had to be incorporated in Spain. Under the new rules, the controlling entity can either be a resident or a nonresident company and all entities under the controlling entity having their tax residence in Spain have to be part of the tax group. The controlling entity must hold, directly or indirectly, a 75% equity interest and a majority of the voting rights.

Limitation on deduction of interest

The 30% EBITDA limitation on the deductibility of interest accrued on debt that is related to the acquisition of an entity which is to be included in a tax consolidated group (or merged into another entity within the next four years after the acquisition), must be calculated using the buyer's EBITDA and not the acquired entity's. The limitation will not apply to the year of acquisition if such acquisition is not more than 70% debt-financed. Additionally, the limitation will not apply in subsequent years when the debt is reduced proportionately during the following eight years until the debt amounts to no more than 30% of the acquisition price.

Goodwill amortization

In the case of a merger, the surviving company will be entitled to step-up the basis of the merged entity's assets, including any goodwill, but only if the merged entity was acquired prior to 2015 and the seller was taxed on the sale.

CFC rules

If a Spanish company owns a CFC that is taxed below 75% of the Spanish income tax rate (i.e., 21% in 2015 and 18.75% as of 2016), the CFC's income must be immediately taxed at the Spanish company level when:

i. The CFC does not have sufficient material and human resources to carry out the activity; or

ii. The CFC's income arises from (a) real estate not used in a business activity, (b) equity interests and interest, (c) capitalization and insurance activities when the beneficiary is the CFC itself; (d) industrial or intellectual property, technical assistance, movable assets, image rights, and business rentals, as well as the transfer thereof; (e) derivative financial instruments; and (f) credit, financial, insurance and service activities performed with Spanish related entities. However, there is a safe harbor rule whereby passive income is only taxed on an immediate basis if the CFC's total passive income exceeds 15% of its overall turnover, except for passive income in (f), which is always taxed on an immediate basis.

Non-resident income tax

Capital gains

Capital gains realized by an EU entity without a PE in Spain on the sale of Spanish shares will be exempt from tax in Spain, unless (i) the assets of the Spanish entity consist mainly, directly or indirectly, of real estate located in Spain, or (ii) the nonresident seller would not have met the participation exemption requirements described above.

Withholding tax on dividends

For the EU Parent Subsidiary Directive to apply when the immediate EU shareholder is owned, directly or indirectly, by a non-EU resident, the immediate EU shareholder must have been incorporated for valid economic and substantial business reasons. The 5% ownership requirement in the Spanish subsidiary can also be met when the

acquisition value of the Spanish entity exceeds EUR 20 million.

The repayment of share premium is to be recharacterised as a dividend to the extent of the distributing company's retained earnings.

Withholding tax on royalties

Royalties paid by a Spanish entity to an associated EU entity will continue to be exempt from withholding tax if the recipient (i) is the beneficial owner of the royalty, and (ii) does not act as an intermediary or authorized agent. If the EU recipient's direct or indirect shareholder is not an EU resident, the EU shareholder must have been incorporated for valid economic and substantial business reasons.

Withholding tax rates

Unless an applicable tax treaty provides a lower rate, the withholding tax rate on dividends and interest paid to nonresidents is reduced from 21% to 20% in 2015 and to 19% in 2016. The same rate will apply to capital gains realized by nonresidents. Other Spanish-source income generated by nonresidents will be taxed at a rate of 24%.

The takeaway

Given the breadth and depth of the changes, multinationals with Spanish operations should consider their impact when reviewing their investment structures in Spain.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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