Tax Insights
from International Tax Services

Spain proposes major tax reforms

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In brief

The Spanish government has released a number of draft bills that, if passed, would significantly amend the laws regarding all major Spanish taxes. The draft bills are currently subject to a period of public consultation. Later this month, the government will send the bills to Parliament for discussion and approval. The tax reforms, if enacted, are expected to come into force between 2014 and 2016.

While the proposed 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 measures similar to those under consideration as part of the OECD's base erosion and profit shifting (BEPS) project.

In detail

Corporate income tax

The principal proposed changes to the corporate income tax regime include the following.

One amendment would reduce the corporate income tax rate from 30% to 28% in 2015 and to 25% in 2016.

Payments to a related party would not be deductible if, at the level of the recipient, (i) they are either not treated as taxable income or are taxed at a nominal rate of less than 10%, or (ii) they are treated as equity. These payments would be characterized based on the treatment given by Spanish commercial law, irrespective of their accounting treatment. Therefore, interest accrued by a Spanish company under a profit participating loan granted by a related party would not be deductible because the instrument is characterized as equity under Spanish commercial law.

Taxpayers could carry forward NOLs indefinitely, but the annual offset would be limited to the higher of 60% of the company's net taxable income or EUR one million.

The tax reform package would slightly modify the requirements for the participation exemption regime. Taxpayers would meet the direct or indirect five percent ownership requirement in the subsidiary if the investment value in the subsidiary is at least EUR50 million. A company would meet the subject-to-tax test if its subsidiary is subject to a corporate income tax that is similar to the Spanish tax and net taxable income is subject to a nominal rate of at least 10%. However, dividends would not be entitled to the Spanish participation exemption when their distribution constitutes a deductible expense at the distributing company level.

A participation exemption regime also would apply to the distribution of dividends between Spanish companies as well as to capital gains on the transfer of shares in Spanish companies.

Fixed asset and real estate impairment losses would not be deductible.

Spanish companies would be entitled to claim a deduction equal to 10% of an equity increase, provided that the

company maintains the increased level for at least five years.

Spanish companies and permanent establishments (PEs) that are heads of a tax consolidation group would be entitled to include other Spanish entities in the group even if they are held through a non-resident company. However, they must indirectly own an equity interest in that entity of at least 75%.

The limitation on the deductibility of interest that is accrued on debt that is related to the acquisition of an entity which is to be included in a tax consolidated group would be calculated using the buyer's earnings before interest, taxes, depreciation, and amortization (EBITDA). This calculation would not include the acquired entity's EBITDA.

In the case of a merger, the surviving company would be entitled to step up the basis of the merged entity's assets, including goodwill. This is possible only if the merged entity is acquired prior to 2015 and the seller is taxed on the sale.

Non-resident income tax

The tax reform package includes the following changes to the non-resident income tax.

The Parent-Subsidiary Directive would be more restrictive than the one currently in force when the immediate European Union (EU) shareholder is owned, directly or indirectly, by a non-EU resident. Under this proposal, the non-EU resident would have to be satisfied that the immediate EU shareholder was incorporated for valid economic reasons and performs substantive business activities other than asset management.

Royalties paid by a Spanish entity to an associated EU entity would still be exempt from withholding tax provided that 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, it would have to be satisfied that the EU shareholder is incorporated for valid economic reasons and perform substantive business activities other than asset management.

Subject to the application of a tax treaty, the withholding tax rate on dividends and interest paid to non-residents would be reduced to 20% in 2015 and 19% in 2016. The same rate would apply to capital gains realized by non-residents. Other income generated by non-residents would be taxed at a 24% rate.

As in the case of Spanish companies, net taxable income generated by non-resident entities through Spanish PEs would be taxed at a rate of 28% in 2015 and 25% in 2016. The relevant tax treaty would govern the PE's taxation of income and deductibility of expenses.

Personal income tax

The package would impose an exit tax on latent gains on shares for individuals who move abroad after meeting certain conditions (e.g., the acquisition value of the shares exceeds EUR four million).

The package would amend the expatriate regime to tax employment income up to EUR600,000 at 24% and the excess at 45%. Dividends, interest, and capital gains would be taxed at rates ranging from 19% to 23%.

The takeaway

Although the proposed amendments are subject to consultation and open to change, significant changes are unlikely during the parliamentary process. Given the breadth and depth of the proposed changes, US multinationals should consider their possible impact when reviewing existing or future investment structures in Spain.

Let's talk

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

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