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LEGAL FLASH | FINANCIAL AND TAX

July 10, 2014

MAIN TAX MEASURES IN THE DRAFT BILLS REFORMING THE SPANISH TAX SYSTEM

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1. INTRODUCTION

On June 20, 2014, the Spanish government made public the draft bills on the long-awaited reform of the tax system (the "Draft Bills"). The tax reform is expected to come into force on January 1, 2015.

The main taxes amended by the Drafts Bills are the following:

- Personal income tax.
- Non-residents income tax.
- Corporate income tax.
- Value added tax

The measures in the Draft Bills set out in this document are provisional and will be subject to amendments during their parliamentary processing before the definitive publication of the laws in the Official Gazette of the Spanish State.

This document describes some of the most significant measures this reform intends to introduce from a crossborder perspective.

2. NON-RESIDENTS INCOME TAX

Under current legislation, the general rate of non-residents income tax will be 24% from 2015, and the tax rate on dividends, interest and capital gains will be 19%. Regarding taxpayers resident in countries in the EU or the European Economic Area with which there is an effective exchange of information, the Draft Bills propose reducing the general tax rate from 24% to 20% in 2015, and to 19% from 2016, while the tax rate for dividends, interest and capital gains for 2015 will be fixed at 20%.

On the Parent-Subsidiary Directive and Interest and Royalties Directive, the Draft Bills modify the anti-abuse provisions applicable when the majority of an EU parent company's voting rights is held directly or indirectly by non-EU shareholders. According to the proposed new anti-abuse clause, the existence of the parent holding company resident in the EU will have to be based on sound business reasons other than the management of securities or other assets.

Regarding real estate investment trusts (*Sociedades Anónimas Cotizadas de Inversión Inmobiliaria* or "SOCIMI"), and effective for tax periods starting January 1, 2014, revenue from transfers or reimbursements to non-resident shareholders holding a stake of less than 5% is excluded from taxation in Spain.

3. CORPORATE INCOME TAX

The reform of corporate income tax involves lowering the tax rate and broadening the tax base. The general tax rate will be reduced from 30% to 28% in 2015, and from 2016, it will be 25%.

The Draft Bills propose the following measures to increase the tax base:

- Non-deductibility of losses resulting from impairment of tangible fixed assets, real estate investment and intangible fixed assets, including goodwill.
- Non-deductibility of expenses in certain hybrid transactions between related parties, such as profit sharing loans and preferred shares registered as debt for accounting purposes.
- Additional limitations on the deductibility of financial expenses from share acquisitions.

Other measures proposed include extending the participation exemption regime to resident qualifying subsidiaries. The requirements for non-resident subsidiaries have been simplified, as the business activity test has been modified and a minimum tax requirement (10% nominal rate) has been introduced.

The Spanish holding regime (*entidades de tenencia de valores extranjeros* or "ETVE") is practically unaltered. The Draft Bills propose increasing the acquisition cost requirement from €6,000,000 to €50,000,000.

Regarding CFC rules, the requirements for applying the regime remain the same: (i) control in the non-resident entity, and (ii) the entity's taxation at an amount lower than 75% of the Spanish corporate income tax. In these cases, the taxpayers must report passive income as defined by the new CFC rules. However, the Draft Bills introduce a new definition of passive income, applicable if the non-resident entity (i) does not have the material and human resources to carry out its activity, unless these resources are held by another non-resident group entity (as per article 42 of the Commercial Code); or (ii) its incorporation and operations have valid economic grounds.

Finally, group taxation will now also be feasible for subsidiaries owned by non-resident entities, following the case law of the Court of Justice of the European Union.

4. PERSONAL INCOME TAX

The main amendments are the following:

CFC rules

The Draft Bills propose applying the CFC rules to individuals in the same way they are applied to companies, even when the controlled non-resident entity is resident in another

EU Member State, unless the taxpayer shows that its incorporation and operations have valid economic grounds and that it carries out economic activities.

Inpatriate regime

The Draft Bills propose softening the requirements applicable to workers who relocate to Spain (inpatriates), enabling the inpatriate regime to be applied regardless of the worker's salary (currently there is a €600,000 limit). Also, the regime can be applied by directors of non-related companies.

However, the regime expressly excludes professional sportspeople.

A general 24% tax rate is established for the first €600,000 and 45% (47% for 2015) on amounts above that. For dividends, interest and capital gains, the rates are the same as those for the personal income tax saving base, i.e.:

Tax base	Tax rate	
	2015	2016
Up to €6,000	20%	19%
€6,000 - €50,000	22%	21%
€50,000 and above	24%	23%

However, workers who relocate to Spain before January 1, 2015, can continue to apply this special regime with the current wording for the period it remains applicable.

Exit tax

New provisions are proposed on exit tax applicable to individuals (i) resident in Spain for five of the last ten tax years, and (ii) holding shares or interests in any type of collective investment institution or company, with a market value exceeding (a) €4 million in the case of portfolio investments, and (b) €1 million in the case of companies in which the taxpayer holds a stake of 25% or more. In this case, the taxpayer would be taxed for any unrealized capital gain when losing Spanish tax residence. This tax can be deferred in certain cases established in the regulation or left without effect if the taxpayer (i) becomes tax resident again in Spain within the five following years, and (ii) did not transfer the shareholdings that were subject to exit tax.

Specific rules are established for a change of residence to a country in the EU or the European Economic Area. These capital gains would only be taxed if, within the 10 years following the transfer, the taxpayer (i) transfers the shares or interest *inter vivos;* (ii) ceases to be resident in the EU or the European Economic Area;, or (iii) does not meet certain obligations.