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Tax Law

July 2021

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CORPORATE INCOME TAX

Order from the National High Court raising a question as to the unconstitutionality of Royal Decree-Law 3/2016

National High Court, through an order dated March 23, 2021 raised an unconstitutionality issue to the Constitutional Court relating to Royal Decree-Law ("**RDL**") 3/2016, which introduced measures that had a significant impact on corporate income tax payments. Those measures are (i) a tighter restriction on offsetting negative tax bases from previous years, (ii) the automatic reversal by one-fifth of the impairment losses on the value of investments recognized in previous years, (iii) the restriction on applying double taxation deductions, and (iv) and the non-deductibility of losses resulting from the transfer of shares in entities. Some of these measures affected the tax period beginning January 1, 2016.

The recently approved Act11/2021, of July 9, on tax fraud prevention measures, has introduced a significant change to the suspension (78 days) of the statute of limitations period approved by RDL 11/2020 as a result of the declaration of the state of emergency due to COVID-19. This change results in that suspension not having any effect with respect to statute of limitation periods ending on or after July 1, 2021. As a result, the tax authorities are likely to reject the 78-day extension for challenging 2016 corporate income tax statements based on the possible unconstitutionality of RDL 3/2016. This means that the deadline for this action ended on July 25, 2021.

The Constitutional Court's doctrine relating to a previous law, RDL 2/2016, regulating corporate income tax payments on account, and to other RDLs, gives reason to believe that the court may well also declare RDL 3/2016 to be unconstitutional.

Spanish Supreme Court judgment on the reversal of impairment relating to an adjustment applied under article 19.6 of the Consolidated Text of Corporate Income Tax Act

Article 19.6 of the Consolidated Text of Corporate Income Tax Act ("**TRLIS**"), in force under the previous corporate income tax regime, set out a special provision on the temporary allocation of the recovery of the value of equity items undergoing a tax deductible impairment, or resulting in a loss due to the transfer of equity items reacquired within six months after their transfer. This rule has been maintained, with slight amendments, in current article 11.6 of the Corporate Income Tax Act.

Including the recovery of the value in cases of transfers regulated under article 19.6 TRLIS has been the subject of debate because the law does not define whether the income deriving from the recovery of the value should be included in the tax base of the company that adjusted the value (transferring entity) or that of the related party holding the asset after the transfer.

The Supreme Court has resolved this issue in its judgment dated May 6, 2021, concluding that the reversal must be applied to the tax base of the company that owns the asset when the value is recovered.

The Supreme Court ruled on the nature of article 19.6 TRLIS (current article 11.6 of the Corporate Income Tax Act) stating that it is not an anti-abuse or anti-avoidance regulation, but rather a rule on temporary allocation.

It states in this respect that "*the meaning and purpose of a temporary allocation rule cannot be artificially forced to convert it into a general anti-abuse provision, changing its interpretation to attribute a yield or a gain—that deriving from the reversal—to the company located in Spain only to maintain or retain the possibility of applying a tax.*"

The Supreme Court thus states that the recovery of the value must occur at the

company that owns the assets since article 19.6 TRLIS "*…defines when the allocation takes place and, in a derivative or indirect manner, the receiving party, which is the owner of the assets at the time of the reversal or the recovery.*"

Judgment issued by the High Court of Justice of Valencia of July 6, 2021, regarding the temporary allocation of corporate income tax on income deriving from amounts refunded by the tax authorities due to the "healthcare cent" (*céntimo sanitario*)

The matter analyzed in this judgment, obtained through Cuatrecasas' legal supervision, arises from the amount refunded by the tax authorities during the 2014 and 2015 financial years to a company that had paid this amount in previous years for a tax applied to the retail sale of certain fuels, known as the "healthcare cent" (***céntimo sanitario***).

The Company included that income in its self-assessments for 2014 and 2015 in accordance with the policy established by the tax authorities and the Directorate-General for Taxation ("**DGT**") (among others, resolutions, V2462-14 and V2861-15). However, the company requested the adjustment of those self-assessments on the grounds that the income should be attributed to the original tax period in which the company received the income from the tax (in accordance with article 19 TRLIS and article 11 of the Corporate Income Tax Act), and not in the financial years in which the tax authorities acknowledged the right to the refund.

The High Court of Justice of Valencia admitted the administrative appeal filed by the company and concluded—contrary to the criterion applied by the tax authorities and the DGT—that this income must be attributed to the original tax period. The court holds that the Court of Justice of the European Union judgment handed down in February 2014 (case C-82/12) declares that the "healthcare cent" violates EU law, has declaratory effects that go against the right to a refund, *ex origine* effects and, therefore, are applicable from the outset. The judgment thus concludes that "*if the refund of an undue charge must be assumed to have accrued at the time the undue charge took place, the temporary allocation of that charge must also be assumed to occur at that moment.*"

As a result of the judgment, it may be worth analyzing the advisability of challenging corporate income tax self-assessments for years in which the refund of the "healthcare cent" by the tax authorities was acknowledged and, therefore, in which the refund was allocated to taxpayers, which resulted in that tax being unduly charged.

PERSONAL INCOME TAX

Central Economic and Administrative Tribunal ruling relating to the calculation of financial losses deriving from donations (*inter vivos* transfers)

The Central Economic and Administrative Tribunal ("**TEAC**") issued a judgment dated May 31, 2021, on the exclusion of losses deriving from donations from the calculation of losses to be included in the tax base for personal income tax ("**PIT**").

In the case analyzed by the TEAC, the taxpayer included losses deriving from a donation made during the year in the calculation of losses to be included in that taxpayer's personal income tax base.

However, the tax authorities and the TEAC consider that financial losses deriving from donations are specifically excluded from the transferor's tax base under article 33.5 of the PIT Act.

The TEAC states in this respect that "*with this measure, the legislator eliminates the possibility of taxpayers including in their tax returns losses originating from actions that depend solely on the taxpayer's will.*"

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The TEAC thus resolves that financial losses deriving from donations are not included for tax purposes for the full acquisition amount or the difference between the acquisition value and the value of the transfer.

Spanish Supreme Court judgment regarding the reduction applicable to certain earned income within a vesting period exceeding two years

In its judgment dated May 6, 2021 the Supreme Court ruled on the the reduction applicable to certain earned income within a vesting period exceeding two years in cases where the taxpayer receives a bonus agreed in 2006 configured as long-term remuneration (2006 to 2011).

The terms of this bonus set out that it would be received in 2011 despite the fact that the employment relationship ended in 2007. The taxpayer applied the reduction for earned income within a vesting period exceeding two years in the personal income tax return for 2011.

The appeal requested the Supreme Court to "*determine, for the purposes of applying the reduction percentages applicable to certain earned income, as established in article 18.2 of the PIT Act, how the legal concept of 'vesting period' should be interpreted in cases where the income becomes payable after the end of the employment relationship and calculating its amount based on that period, either by considering that the period corresponds to the full incentive program term until it ends or considering only the time during which the employee rendered services to the company.*"

The Supreme Court rejected the appeal after reaching the conclusion that for the purposes of the application of the reduction percentages for certain earned income "*the legal concept of 'vesting period' must be interpreted to be that over which the recipient effectively contributes to the generation of the income deriving from the incentive program implemented by the payer, regardless of whether that remuneration becomes payable after the end of the employment relationship.*"

In the case analyzed, the Supreme Court considers that the bonus received is not associated with a vesting period exceeding two years because the calculation takes into account several years in which the taxpayer did not participate in the generation of that income (the employment relationship ended in 2007) and, therefore, the reduction for certain earned income within a vesting period exceeding two years is not applicable.

Central Economic and Administrative Tribunal ruling on the calculation of travel time for the purposes of the exemption provided under article 7.p of the PIT Act

In its ruling of February 17, 2021, the TEAC changed its policy and adapted to the opinion issued by the Supreme Court in its judgment dated February 25, 2021, in which it allows the application of exemption on earnings obtained from work performed abroad taking travel time into consideration.

It should be noted that the Supreme Court resolved that the time an employee uses to travel to the country of destination or return to Spain is an obligation imposed by the employer. Accordingly, travel time must be taken into account when calculating the exemption since it forms part of the employee's working day.

The TEAC has changed its policy and adapted to the new criterion.

For further information, please see our Legal Flash of March 8, 2021, at the following link.

WEALTH TAX

Supreme Court judgment on the scope of the exemption established in article 4.8.2 of the Wealth Tax Act to participatory loans granted by individuals

The Supreme Court reached a decision in its

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judgment dated March 30, 2021 on the application of the exemption set out in article 4.8.2 of the Wealth Tax Act to participatory loans granted by individuals to companies.

In the case raised to the Supreme Court, the taxpayer requested the application of that exemption with respect to the value of a loan granted to a company in which the taxpayer held an equity interest.

The appealing party argued, among others, that for commercial purposes, a participating loan is considered to be equity (own funds) and, accordingly, based on a purposive interpretation of the law, the exemption established under article 4.8.2 of the Wealth Tax Act is applicable to the participatory loan granted to the company.

The Supreme Court rejected the appeal, stating that "*participatory loans are not securities representing interests in the equity of a company, but rather represent the assignment of capital to third parties to which the exemption established by article 4.8.2 of Act 19/1991, of June 6, does not extend.*"

The court also clarified that "*equating a participating loan equal with equity for the purposes of reducing the share capital and liquidating a company does not alter its status as a loan agreement as the creditor's situation is not similar to that of the shareholders of the borrowing company.*"

The Supreme Court therefore disallows the application of that exemption to participatory loans on the basis that participatory loans are not securities representing an interest in the capital and reserves of a company, but rather represent the assignment of capital to third parties.

It should be noted that the judgment from the Supreme Court does not cover the tax treatment of ordinary/participatory loans made by parent companies to subsidiaries.

VALUE ADDED TAX ("VAT")

New VAT regulations on ecommerce

On April 28, 2021, the Official Gazette of the Spanish State published Royal Decree Law 7/2021, of April 27, on the transposition of European Union directives on competition, anti-money laundering, credit institutions, telecommunications, tax measures, prevention and remedying of environmental damage, posting of workers in the framework of the transnational provision of services and consumer protection.

Royal Decree Law 7/2021 transposes two EU VAT ecommerce directives, namely Directive 2017/2455, as regards certain value added tax obligations for supplies of services and distance sales of goods; and Directive 2019/1995, as regards provisions relating to distance sales of goods and certain domestic supplies of goods.

The new VAT ecommerce rules became applicable on July 1, 2021, mainly affecting online sellers, electronic interfaces, postal operators, courier and transport firms, and EU consumers.

For further information, please see our Financial and Tax Legal Flash of April 2021.

OTHER DEVELOPMENTS

Anti-tax Evasion Act

On July 10, 2021, the Official Gazette of the Spanish State published Act 11/2021, of June 30, on measures to prevent and combat tax fraud, transposing Council Directive (EU) 2016/1164, of July 12, 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market, amending various tax rules and regulating gambling .

This law against tax fraud approves a wide range of measures of differing importance in

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the tax area and affects most national taxes. These measures notably include the change to international tax transparency and to exit tax, a modification to the system governing REITS (including the transitional system allowing their dissolution and liquidation, within certain deadlines, and with an advantageous tax system), and the replacement of actual value by the assessed cadastral value with respect to wealth taxes. They also update and expand the concept of tax havens, which are now called "non-cooperative jurisdictions" while introducing numerous amendments to the General Tax Act that affect surcharges for late filings and late payment interest.

Act 11/2021 has introduced a major amendment to the suspension (78 days) of the statute of limitations period approved by RDL 11/2020 as a result of the declaration of the state of emergency due to COVID-19, as mentioned above. Specifically, it stipulates that this suspension will not have any effect on statute of limitation periods ending as from July 1, 2021, which must be calculated in the ordinary manner. As a result of this measure, the tax authorities are likely to reject any extension to the deadline for challenging corporate income tax returns for 2016 based on the possible unconstitutionality of RDL 3/2016.

For further information, please see our Financial and Tax Legal Flash of July 2021.

National High Court judgment on the compatibility of the anti-abuse clause established under article 14.1.h of the Non-Resident Income Tax Act with European Union Law

In its judgment dated May 21, 2021, National High Court changed its criterion with respect to the compatibility with European Union Law of the anti-abuse clause set out in article 14.1.h of the Non-Resident Income Tax Act.

It should be noted that this legal text provides an exemption for dividends paid by Spanish companies to their EU parent companies, while the anti-abuse clause disallows the exemption under certain circumstances when the parent is controlled by non-EU shareholders.

The case at hand refers to the wording of the anti-abuse rule in force before 2015, which placed the burden on the taxpayer to prove that the EU parent receiving the dividend had been incorporated for valid economic reasons. The position held to date by the Spanish courts accepted this reversal of the burden of proof, although recent rulings by the European Court of Justice, as the Central Criminal and Administrative Court states in its judgment, radically disagree.

The Court of Appeals therefore considers the adjustment applied by the tax authorities to be incorrect as it was based on a presumption of abuse because the entity receiving the dividend was controlled by a Canadian pension fund.

Supreme Court judgment on the classification of the retail marketing of electricity within the business activity tax rates

Supreme Court judgment dated May 12, 2021 (Appeal 6913/2019), clarified the Business Activity Tax heading under which the retail marketing of electricity to final consumers should be classified.

This matter had not been resolved with respect to business activity tax rates after the entry into force of several electricity sector liberalization laws (Acts 30/1995 and 54/1997). The activities—unified up until then—of generating, transmitting, distributing and marketing electricity progressively became separated to allow free market competition between electricity market operators, who had been carrying out those activities separately.

In contrast to the case of generation, transmission and distribution of electricity, which were classified under heading 151.5 of those rates and were able to register for a provincial or national rate, the electricity marketing activity was not listed in the business activity tax rates. This led to the suppliers of marketing services to register

under headings such as 619.9 for the retailing of other products, which has only been assigned a municipal rate and required registration in each municipality in which the service was provided, and leading to the administrative burden of complying with the tax.

Although the matter was finally resolved by the recently enacted Act 11/2020, of December 30, General State Budget for 2021, which created a new heading, 151.6 "Marketing of electricity" effective from January 1, 2021, offering the possibility of registering for the tax at the municipal, provincial or national level, the Supreme Court also reached the same solution for a dispute raised in an appeal.

In the court's opinion, the retail marketing of electricity forms part of a single cycle consisting of different stages (e.g., production, transmission, distribution and delivery to consumers), which is a single process, not only under the new legislation liberalizing the electricity sector, but also in accordance with the preceding legislation under which the cycle was carried out by an oligopoly. Based on the above, the court also indicates that Common Note 5 for Group 151 "Production, transmission and distribution of electricity" establishes that the kilowatts contracted are measured at the contracted point of delivery to the consumer for the purposes of the application of heading 151.5. This undoubtedly confirms that the marketing activity forms part of the distribution or supply stage and, consequently, that activity should be included in heading 151.5 "Transmission and distribution of electricity," which specifically allows the choice of applying the municipal, provincial or national rate.

Administrative doctrine relating to tax on certain digital services

The DGT and the tax authorities have each published documents clarifying their policy regarding certain matters relating to tax on certain digital services.

The first is the resolution adopted by the DGT on June 25, 2021, on the Tax on Certain Digital Services (accessible here).

In the second case, the tax authorities has published FAQs on its website (accessible in Spanish and in English).

OECD and European Commission documents regarding the international tax reform

The OECD is making progress with its negotiation process to review the basic standards of international taxation.

Those standards are based on two Pillars:

(i) Pillar One aims to create a new tax authority to apply taxes to large business groups in the countries in which their customers reside, regardless of whether they have a physical presence in those countries.

(ii) Pillar Two aims to ensure a minimum global tax for large companies.

The agreement dated July 1, 2021, provides details regarding the general aspects of the progress made to date, notably including the establishment of a 15% minimum tax rate. The OECD makes mention of the October publication of the details associated with the implementation of these agreements which, in any event, are intended to take effect as of 2023.

On May 18, 2021, the European Commission published the Communication on Business Taxation for the 21st century. In that Communication, the Commission presents its comments regarding progress made by the OECD and the tax proposals on which it intends to work in coming years.

Those proposals notably include its intention to recommence the corporate income tax harmonization project, and specifically announce its development using the new acronym BEFIT, which stands for Business in Europe: Framework for Income Taxation. The

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Communication also refers to a new proposed Directive regarding a new European digital tax, although the Commission seems to be weighing up the possibility of ceasing this project given that the solution under Pillar One of the OECD has the precise intention of repealing digital taxes approved to date as unilateral responses by Member States.

For additional information, please contact Cuatrecasas.

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