Real Estate Tax Services News

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Spanish Draft 2021 Budget Bill: Preparing for the proposed tax measures in the real estate industry

In brief

On 27 October 2020, the Spanish coalition Government approved the Draft 2021 Budget Bill. One key corporate tax provision is to reduce the participation exemption for dividends and capital gains to 95%.

The Spanish Government also approved a tax bill on 13 October 2020 that introduced several other tax measures, including the implementation of certain provisions contained in the EU's Anti-Tax Avoidance Directive ("ATAD") and an overhaul of the tax haven rules to align with EU and OECD standards.

Some of the corporate tax measures included in these two legislative proposals could apply retrospectively to tax years commencing on or after 1 January 2020.

We analyse below the corporate and individual tax measures included in the 2021 Spanish Draft Budget Bill and, in particular, those which may require action by investors in Spanish real estate to ensure that tax implications are effectively managed.

In detail

The Draft 2021 Budget Bill as published seeks to enact parts of the political agreement reached by both parties in the current coalition Government. Consistent with that agreement, the draft budget includes several tax increases that would help fund some of the agreement's public spending proposals.

The 13 October 2020 Bill includes several tax measures aimed at improving tax compliance and reducing tax litigation. In this context, the bill transposes into domestic legislation some of ATAD's provisions by amending existing exit tax and Controlled Foreign Corporation ("CFC") rules.

None of the changes relate to the ATAD's general anti-abuse rule ("GAAR"), as the Government has indicated that existing domestic GAARs already meet the EU directive's standards. Also, the EU Commission has agreed that the Spanish Corporate Income Tax Law's ("CITL") interest limitation rules are equally effective provisions, and therefore Spain may defer adopting the ATAD rules until 2024.

The anti-hybrid rules in Directive 2017/952 dated 29 May 2017 ("ATAD 2") will be included in separate legislation. The Government has announced that a draft bill will be published and subject to consultation in the coming weeks.

Limitation of the Spanish participation exemption regime

The Draft 2021 Budget Bill reduces the current participation exemption on dividends and capital gains from qualifying shareholdings to a 95% exemption. The change would apply to income derived from both foreign and domestic qualifying subsidiaries and results in an effective tax rate of 1.25% on dividends and capital gains (i.e. 5% non-exempt income multiplied by the 25% statutory tax rate).

PwC observation

This 5% addback also would apply to dividends and capital gains generated within a tax consolidation group. The proposed rules include a narrow exception for companies that are not part of a group and have a turnover of less than 40 million EUR. These smaller entities would be allowed to fully exempt dividends received from wholly owned subsidiaries formed on or after 1 January 2021, but only during the three years following their formation year.

The participation exemption reduction could significantly impact Spanish holding companies ("ETVEs").

Change in the exit tax rules to align with ATAD

The CITL currently includes an exit tax provision that generally applies whenever a company shifts its tax residence from Spain to a foreign jurisdiction. However, when the tax residence shifts to an EU or European Economic Area ("EEA") jurisdiction, the taxpayer may defer the capital gains tax payment until the assets of the company are transferred to a third party.

In line with ATAD, the proposed rules would eliminate this deferral, but would give the taxpayer transferring assets or migrating to an EU or EEA jurisdiction the option of paying the tax in five equal annual instalments. When there is a migration or transfer of assets from another EU jurisdiction and the migration has been subject to an exit tax in the exit state, Spain would recognise a tax basis in the assets that is equal to the value assessed by the exit state, unless it is not arm's length.

Broader CFC rules in line with ATAD

The proposed legislation would broaden the scope for applying Spain's existing CFC rules to better align them with ATAD.

The current Spanish CFC rules only apply to non-resident subsidiaries of Spanish taxpayers. However, the bill extends application of the CFC rules to foreign permanent establishments ("PEs").

If a foreign subsidiary or PE generates passive income and that income is subject to income tax at an effective rate lower than 18.75% (i.e. 25% x 75%), then the income would be immediately subject to Spanish income tax, and – in the case of PEs – would not be eligible for the branch exemption.

The Bill would expand the passive income concept to include two new categories:

- Income generated from insurance, banking, financial leasing, and other financial activities, unless the activity is deemed to constitute a business activity, and
- Sales and services income from transactions with related parties, when the CFC adds no or little economic value.

The current CFC rules include a safe harbour measure whereby income from financial, insurance, leasing, and service activities is not regarded as passive if the CFC generates at least 50% of the income from unrelated parties. The Bill's new rules would raise this threshold percentage to at least two thirds (i.e. 66%) of income from unrelated parties.

Furthermore, the Bill would repeal an existing carve-out in the CFC rules for certain intermediate holding companies.

PwC observation

The expanded application of the CFC rules to foreign holding companies, along with the participation exemption reduction to 95%, could result in a CFC inclusion of income derived by foreign holding companies when they benefit from a full participation exemption on dividends and capital gains received. The proposed CFC rules would not apply to EU and EEA subsidiaries and PEs, provided they carry out an economic activity. The current rules only carve out EU-resident subsidiaries.

Tax increase for individuals

The Spanish Draft 2021 Budget Bill includes personal tax provisions. Among them, some may impact individual Real Estate managers, notably a new national income tax bracket for resident individuals: a 24.5% rate for taxable income in excess of EUR 300,000. The marginal national income tax bracket currently stands at 22.5% for taxable income in excess of EUR 60,000.

Taxation on investment income would increase by three percentage points, currently standing at 26% for investment income in excess of EUR 200,000. Investment income includes dividends, interest, and most capital gains.

PwC observation

When combined with the regional income tax bracket, the marginal tax rate for high-income earners would reach 50% in some Spanish regions.

Other relevant tax measures

Other significant tax measures of the two bills that may impact the Real Estate sector include:

- Tax havens: The Spanish tax havens list was last updated in 1991. The proposed legislation would expand and modernise the criteria used for the designation of “non-cooperative jurisdictions” (the tax haven denomination would be repealed) to align with recent EU and OECD initiatives, and would provide for a periodic review and update of the list of non-cooperative jurisdictions and harmful tax regimes.
- Tax surcharges and penalties: The General Tax Law would be amended to reduce surcharges in the case of voluntary late payments. Similarly, the current 25% reduction for prompt payment of penalties would be increased to 40%. The stated objective of these provisions is to increase voluntary tax compliance and reduce tax litigation.

Legislative process ahead and entry into force

The entry into force dates differs for the above-mentioned provisions.

The exit tax and CFC rule amendments would apply to tax years commencing on or after 1 January 2020 and not ending by the date the legislation enters into force (for example short tax years).

The changes to the Spanish participation exemption regime would apply to tax years commencing on or after 1 January 2021, if they have not ended by the date the budget law enters into force.

DAC 6

In addition to the measures mentioned before, the transposition of DAC 6 into Spanish law is also to be expected.

On 20 June 2019, the Spanish Ministry of Finance published the draft bill implementing the EU Directive on the mandatory disclosure and exchange of information on cross-border tax arrangements (the so-called “DAC 6”). The public consultation finished on 12 July 2019.

The draft bill generally follows the wording of the EU Directive with some minor deviations, namely in relation to hallmarks, penalties and the legal professional privilege. On 12 May 2020, the Spanish Government approved the draft bill, amending the General Tax Act to introduce (i) the DAC 6 reporting obligations, (ii) the regulation of the legal professional privilege and (iii) the regulation of penalties.

This draft bill needs now to be finally approved by the Parliament. It is expected that the vote will happen before the year-end (to be confirmed, however).

Our view

Since the Spanish Government does not have a majority in either house of Parliament, it will need the support of several other political groups in order to secure the vote of both pieces of legislation. Some of these measures could therefore be dropped or modified during the legislative process.

Real Estate investors with operations in Spain or with Spanish holding companies should assess the impact of the proposed changes on their investments in Spain and prepare to respond accordingly, especially when considering the new 95% cap on the participation exemption (dividends and capital gains).

Among the other potential changes that are particularly relevant for current and future Real Estate investment structures, the Spanish Government has announced changes in the taxation of SOCIMIs. The most notable of the proposed changes is the introduction of a 15% tax on undistributed earnings of these entities. It should be noted that the minimum 15% rate has not been included in the Draft Budget Bill and must therefore be approved through a different procedure.

From a market perspective, it is also worth highlighting that the Draft 2021 Budget Bill identifies infrastructure investments as a strategic objective for Spain's economic recovery. In this context, the Spanish Government proposes to allocate approximately EUR 6 billion to infrastructure (including EU funding).

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