Tax reform in Spain: New Corporate Income Tax Act and other tax amendments

The first set of the Spanish tax reforms has finally arrived. On 28 November 2014, the Spanish Official Gazette published the new Corporate Income Tax Act as well as a number of amendments to the Personal Income Tax, Non-Resident Income Tax, and VAT Acts. The new laws will come into force in 2015 with some measures becoming effective in 2016 and some with retrospective effect in 2014.

A second set of the tax reforms is expected in the first quarter of 2015 consisting of amendments to the Spanish General Tax Act.

This News Alert briefly summarises some of the new Corporate Income Tax and Non-Resident Income Tax measures which may be of interest in the real estate market.

Corporate Income Tax

- The standard CIT rate will be reduced from the current rate of 30% to 28% in 2015 and to 25% from 2016 onwards.

- The law includes a definition for a real estate lease as a business activity which may be relevant for some tax incentives. At least one full-time employee is required for management of the lease activity to qualify as a business activity as opposed to a passive activity. The full-time employee can be hired by any member of the corporate group.

- Official straight-line depreciation rates have been simplified.

- Accounting impairments of fixed real estate assets will not be tax deductible until the properties are disposed of.

- An additional interest capping rule is being introduced to counteract leveraged buyouts, optimised through structures involving a tax grouping or merger (unless certain leverage and repayment conditions are met).

- The existing indexation allowance that has previously been available on the disposal of real estate has been removed.

- Interest derived from profit participating loans granted by members of the same corporate group will not be tax deductible.

- Expenses derived from transactions with related parties will not be tax deductible if there is a different classification of the transaction by each party, and as a result of this, any income generated at the level of the counter party is exempt or subject to a
tax rate lower than 10%, or no income is deemed to be generated.

- The reinvestment relief will be replaced by a capitalisation reserve resulting in a maximum reduction of 10% of the taxable base.

- A new domestic participation exemption will be available for Spanish resident entities in connection with dividends and capital gains obtained in Spain, subject to certain conditions.

- In 2017 onwards, the taxable profits for the period may be reduced by brought forward tax losses up to the higher of 70% of the taxable base of the period or €1m, except for the period in which the company is wound up. Transitional restrictions are established for 2015, 2016 (State Bill draft).

- Tax losses may be carried forward with no time limitation. However the statute of limitations has been extended to 10 years.

- Forfeiture rules on tax losses carried forward have been amended. The right to utilise tax losses is lost if, together with other requirements, the target company has not carried out any business activity (as defined by the law) in the 3 month period prior to the transfer.

- Dividends distributed between Spanish resident entities applying the SOCIMI regime (Spanish REIT) will not be subject to domestic withholding tax.

### Non-Residents Income Tax

- Domestic withholding tax rate for dividends, interest and capital gains will be reduced from the current rate of 21% to 20% in 2015 and to 19% in 2016.

- The standard rate for permanent establishments (PE) will be reduced from 30% to 28% in 2015 and to 25% in 2016.

- The rate for income obtained by non-residents without a PE will be reduced from 24.75% to 24% in 2015. However, for EU residents without a PE, the rate will be reduced to 20% in 2015 and to 19% in 2016.

- Non-resident companies investing in Spain without a PE should take into account the new CIT rules in order to determine whether the expenses directly linked with the activity carried out are allowable for tax purposes.

- The wording of the domestic anti-avoidance clause for the application of the EU Parent Subsidiary Directive withholding exemption on dividends has been amended.

- Capital gains derived from the disposal of SOCIMI shares listed in the Spanish stock exchange will be exempt in Spain for non-resident shareholders that hold less than 5% of the share capital in the SOCIMI.

### Our view

The new CIT Act retains the structure of the old CIT, using the accounting profit as a basis, and then adjusting it in order to determine the taxable profits. Alongside the reduction of CIT rates, the new legislation intends to preserve taxation collected by the Spanish state by denying tax relief for interest on intragroup profit participating loans, some related party expenses, and other matters. The new legislation already includes BEPS type measures, for instance the new clause with the purpose of neutralising the effects of hybrid mismatch arrangements.

In addition, the restriction on the utilisation of brought forward tax losses will become permanent and apply to all taxpayers, as opposed to the temporary rules only applicable for large companies.

On the other hand, the reduction of domestic tax rates for non-residents is welcome. The new anti-abuse test for the withholding tax exemption on dividends will require careful consideration on a case by case basis.

Finally, we strongly recommend carrying out a comprehensive review of the new legislation and measures stemming from the tax reform in order to determine the potential impact on existing investments as well as to update the estimated tax costs in Spain for new investments in the pipeline.
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