TAX ALERT– 2015 Corporate Tax Reform

December 2014

A complete revision of the Spanish Corporate Tax Law has been approved and published in the Official Gazette on November 28th 2014.

The tax reform will become effective on 2015 including extensive changes to the Corporate Tax and Personal Income Tax, and technical adjustments on Non Resident Income Tax and Value Added Tax (VAT). Amendments to the General Tax Act are also in progress and will most likely be approved on 2015.

This tax alert outlines the main Corporate Tax amendments introduced for tax periods starting January 1st 2015.

Tax deductible expenses

- **Financial expenses:** the general limitation on the tax deductibility of net financial expenses (i.e. 30% of EBIDTA) exceeding EUR 1 million will remain unchanged, although the following adjustments and restrictions have been introduced:

  (i) The net financial expenses that exceed the deductibility limits maybe carried forward indefinitely (up to 2014 there was an 18-year limit).

  (ii) Leveraged buy-out: interest deductibility for financed acquisitions of company shares performed after June 20th 2014, is limited to 30% of the acquiring company's operating profit (not taking into account the operating profit of the acquired entity, isolated from possible merger transactions or from Corporate Tax consolidation). This limit will not apply in the taxable year in which the shares are acquired if the acquisition is funded with debt not exceeding 70% of the acquisition price. In subsequent years, the limit will not apply if the debt decreases proportionally in each of the eight years following the acquisition date, up to 30% of the acquisition price.

- **Special anti-abuse rule for hybrids:** deductions for expenses incurred in transactions with related parties are disallowed when, as a result of different tax characterizations, either (i) no income will be generated, (ii) income will not be subject to tax or (iii) income will be subject to a nominal tax rate of less than 10%.

- **Participating loans:** Intragroup participating loans granted from June 20th 2014 will be characterized as equity instruments rather than debt and, therefore, "interest" payments on such loans will be nondeductible.

- **Asset Depreciation:** the general depreciation tables to determine tax deductible depreciation have been simplified and free tax depreciation of assets used for R&D activities is maintained.

  Regarding intangible fixed assets, those with a definite useful life will be amortized for tax purposes based on their useful life (the previous law established a 10-year depreciation period) and those with an indefinite useful life (including goodwill) will be tax deductible over a 20-year period, irrespective of the amortization for accounting purposes.

- **Impairment of assets:** the impairment of tangible fixed assets, real estate investments, intangible fixed assets (including goodwill), securities representing a capital or equity shareholding in an entity and debt securities become nondeductible for tax purposes.

  Losses derived from these items will be deductible only when transferred to third parties, applying assets' depreciation rates or when they are written off from the balance sheet.

  This measure completes the progressive recent tax restrictions to the deductibility of the accounting extraordinary adjustments of value on assets, rights and shares.

- **Customer or supplier entertainment expenses:** will be deductible only up to 1% of the company's turnover.

Tax losses

The rules governing the use of tax losses have been substantially modified:

- Tax losses available in the first tax period starting after January 1st 2015, may be carryforward indefinitely (up to 2014 there was an 18- year limit).

- As from 2016, the annual offset will be limited to the up to 70% of the company´s net taxable income or EUR 1 million, with special rules for company liquidations and impairment tax reversals.

- The restrictions to the use of tax losses in case of a change in control have been tightened.

- Tax authorities will be entitled to audit and review tax losses for a period of 10 years.

- Temporary restriction to the use of tax losses will continue to apply on 2015 (50% for companies with a turnover between EUR 20 million and EUR 1 million and 25% for companies with turnover exceeding EUR 60 million).

Tax rate

The general corporate income tax rate of 30% will be reduced as follows:

2014	2015 (*)	As from year 2016 (*)
30,00%	**28,00%**	**25,00%**

(*) These rates will apply to tax periods starting after January 1st of each year.

Tax credits

- **Abolished tax credits:** the following tax credits will be abolished as from 2015: environmental investment credit, the reinvestment credit and the profit investment credit.

However, available tax credits from former periods may be applicable with the current quantitative and temporary limits.

- **Capitalization reserve**: the objective of this new tax benefit is to increase Spanish entities' net equity by keeping retained earnings undistributed. The capitalization reserve will allow applying an out-of-books tax adjustment equal to 10% of the increase in net equity in a particular tax year, provided the company maintains the net equity increase during the following five years (except in the case of accounting losses) and creates an accounting undistributable reserve for the same amount.

  The adjustment may not exceed 10% of the taxable base before the deduction, adjustments for deferred tax assets and the use of previous period tax losses. The excess may be carried forward for the following two years, subject to the applicable limit for each year.

- **R&D tax credit:** this tax incentive will be maintained. The scope of R&D will include advanced software activities (currently excluded).

- **Participation exemption:** the participation exemption has been amended to allow its application to Spanish subsidiaries; until now it only applied to investment in foreign entities.

  As from 2015, the general requirements to apply for the participation exemption regime of dividends and gains will be the following: (i) a minimum ownership percentage (5%) or cost of acquisition (€20 million) and a one-year minimum holding period in the subsidiary; (ii) a minimum level of (nominal) taxation of 10% under a foreign corporate tax system similar to the Spanish CIT would also be required for foreign subsidiaries

  The proposed rules also introduce a system for the calculation of exempt dividend and gains derived from multi-tiered structures and anti-abuse rules.

  Similar changes have also been introduced in the foreign branch exemption rules.

Transfer Pricing and Special Tax Regimes

- **Transfer pricing:** Shareholders and entities will be deemed to be related where the shareholder participation is at least 25% (currently 5% or 1% for listed companies) or where decision-making power is or may be exercised.

  Suppression of the hierarchy of valuation methods to determine the fair market value and other methods not foreseen in the law will also be acceptable.

  Simplified documentation requirements will be introduced for entities or groups whose turnover does not exceed EUR 45 million.

  Director's fees will be excluded from the scope of the TP rules.

  The penalty regime will become less burdensome.

- **Consolidated tax regime:** The percentage of voting rights required to form a consolidated group will remain at 75% (70% for listed companies), but the parent company will be required to hold more than 50% of the voting rights.

Spanish companies and permanent establishments (PE) that are head of a tax consolidation group will be obliged to include other Spanish group entities and PEs in the tax consolidation group even if they are held through a non-resident company, since as from fiscal year 2015, the holding requirement will be analysed at group level and not at the Spanish holding company level.

The inclusion of PE of foreign entities as dependent entities of a Spanish consolidated group, provided certain requirements are met, is also new for 2015 since up to 2014 EP may only act as head of a Spanish Tax consolidation group.

- **Tax-neutral regime for reorganizations:** among the several technical improvements introduced the following should be highlighted:

  (i) Goodwill and asset step-ups resulting from a merger will no longer be tax deductible. However, there shall be a transitory regime by which the merger goodwill and asset step-ups previous regime will be maintained for transactions taking place after January 1st 2015 if the acquisition of the absorbed entity took place before January 1st 2015.

  (ii) Tax losses attributable to an acquired entity's activities may be carried over to the acquiring entity (in cases of mergers, partial or total spinoffs and contributions in kind). Under the current legislation, this was only possible if the company that generated the tax losses was extinguished (circumstance that applies in mergers and total spin-offs).

- **CFC regime:** in line with BEPS initiative, the Spanish CFC rules have been amended and relevant changes on material and personnel resources requirements at the level of the CFC have been included.

  The changes introduced to CFC regime will require to carefully analyze international structures held directly or indirectly by Spanish taxpayers to discard adverse tax implications or to introduce the appropriate measures.

Should you require any additional information, please contact one of the following tax specialists:

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