GARRIGUES

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Lately, we have seen a strong focus by the Spanish government and lawmakers on fighting tax fraud, both at home and abroad. A wide range of measures are being adopted (i) on the one hand, to encourage taxpayers to disclose unreported assets, through an apparently reduced taxation rate, and, (ii) as a counterpoint, to stiffen the consequences of keeping those assets concealed, which adds to the appeal of making the disclosure. In keeping with this focus:

- Special tax rates have been approved in 2012 to encourage the repatriation of foreign income by corporate income taxpayers (tax rates of 8% and 10% on this type of income, where the requirements are not met for it to be exempt), and personal income tax, corporate income tax and nonresident income taxpayers have been given the option to be taxed at 10% on the assets they report (on the portion of assets acquired with income obtained in open tax periods). In all of these cases, the voluntary disclosure must be done by November 30, 2012.

- The anti-fraud law has just been published (Law 7/2012, of October 29, 2012, mentioned below and described in detail in our tax law update 8/2012) which (i) places restrictions on cash payments starting on November 19, 2012, and (ii) establishes new disclosure obligations in relation to assets and rights abroad, which, if breached, alongside serious penalties, can mean that if those assets are detected, their value will be classified as undisclosed income (for corporate income tax purposes) or as an unjustified increase in assets (for personal income tax purposes) without being able to argue or support that they derive from a time-barred year.

- A reform of the criminal code is being discussed by parliament and is expected to stiffen penalties, primarily where fiduciary structures or tax havens are used or where the evaded amount of tax exceeds €600,000, and to lengthen the statute of limitations period for tax offenses.

- Added to all of the foregoing are the provisions and initiatives aimed to obtain and use information on assets and income abroad, in an international context which is increasingly aggressive towards countries that do not provide information. They include the Council Directive of February 15, 2011, on mutual assistance between the Member States in the field of direct taxation, the new tax treaties, the amendment of existing tax treaties with revised information exchange clauses, the negotiation of a new protocol with Switzerland, and the announcement of the creation of a new National Office for International Taxation to fight against international tax fraud.

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1. JUDGMENTS

1.1 Corporate income tax.- Essential requirement for information on the reinvestment tax credit to be included in the notes to the financial statements for it to apply (National Appellate Court. Judgment of September 20, 2012)

In this judgment, the National Appellate Court revisited a traditionally controversial topic; whether the taxpayer should be able to claim a reinvestment tax credit even when the decision to claim it does not expressly appear in the notes to the company's financial statements, a requirement expressly established in tax legislation.

The appellant argued that this requirement must be held to be met implicitly by the financial statements because the tax credit had been included in the calculation of the corporate income tax expense, adding that, in any event, this would be a breach of a mere formality which does not prevent the tax credit from being claimed.

The chamber held, however, that the breach of the requirement to validly reflect the tax credit in the notes to the financial statements cannot be held to be a mere matter of form but rather it concerns the essential requirements under the rules on the tax credit, as it is the shareholders' meeting that must elect to apply these rules by approving the notes to the financial statements.

In short, according to this court, the tax credit does not apply automatically but rather the taxpayer must decide and elect (in the manner stated in the law) whether or not to apply that legal provision.

1.2 Personal income tax.- Legally separated spouse can elect to file joint return with the children who live with him once claim for separation is admitted (Valencia High Court. Judgment of May 8, 2012)

A taxpayer who is legally separated can elect to file joint tax returns with the children who live with him once there is a court decision giving leave to proceed with the claim for separation, which takes effect from the submission date, even if the separation judgment has not yet been obtained. The court held that the decision giving leave to proceed with the claim for separation stays the effects of the marriage.

1.3 VAT.- Exemption cannot be disallowed for intra-EU supply if supplier acts in good faith and has adopted all reasonable measures to provide identification number (European Court of Justice. Judgment of September 27, 2012, Case C-587/10)

The court analyzed the case of a German company that sold goods to a US company. The German company asked the US company for its VAT identification number. This company (which did not have a VAT number) replied that it had resold the goods in

question to a company established in Finland and provided this company's VAT identification number, which the subsidiary confirmed. The goods were indeed transported directly from Germany to Finland.

The German company issued a bill to the US company without VAT, specifying in the bill the VAT identification number of the Finnish company to which the goods had been resold. The tax authorities held that the supply by the German company to the US company could not be exempt from VAT because the US company had not provided its own VAT identification number.

The European Court of Justice ("ECJ") held that:

- The Directive does not prevent the tax authorities of a member state from making the VAT exemption of an intra-EU supply conditional on the supplier providing the VAT identification number of the acquirer.

- However, making the right to the VAT exemption for an intra-EU supply conditional on the fulfillment of formal obligations, without taking the substantive requirements into account and, in particular, without asking whether they were met, goes beyond what is necessary to ensure the correct collection of the tax.

- In this regard, the tax neutrality principle requires the VAT exemption to be granted if the substantive requirements are met, even if the taxable person has omitted certain formal requirements, and the opposite conclusion could only be reached if the breach of those formal requirements were to prevent specific proof being produced that the substantive requirements have been met. This holds true provided that the supplier of the goods has not deliberately participated in tax fraud or imperiled the functioning of the common VAT system.

- Although the VAT identification number proves the tax status of the taxable person and enables the taxation of intra-EU transactions to be monitored, it is a mere formal requirement that cannot impinge on the right to the VAT exemption.

- In this case, the supplier asked for its customer's identification number and the customer, which did not have one, provided the VAT identification number of the second buyer; accordingly, it does not appear that either of the parties involved acted fraudulently.

Note that Spanish legislation, specifically article 25 of the VAT Law, makes the exemption conditional on the acquirer being a trader or professional, identified as such for VAT purposes. This judgment could therefore be very useful when the exemption is disallowed in intra-EU transactions because the VAT number has not been provided by the supplier, if it has acted in good faith and used all the means available to it to do so.

1.4 Real estate tax.- Beneficiary of condemnation will be the cadastral owner of condemned assets for real estate tax purposes (La Rioja High Court. Judgment of May 3, 2012)

Cadastral ownership of rural property condemned for the construction of a dam had been attributed to the claimant engaged to build it, as it was considered the beneficiary of the condemnation.

The claimant, however, argued that cadastral ownership pertained to the government, as the owner of the condemned rural property and future owner of the dam to be built.

The chamber held, however, that as the claimant had the status of beneficiary of the condemnation, and that precisely that beneficiary represented the public or social interest for which it is authorized to claim that the condemning authority exercise its powers of condemnation, the attribution of cadastral ownership to the claimant is lawful.

1.5 Review proceeding.- The intention to appeal, properly evidenced in a timely manner to an administrative body, prevents it from rejecting an appeal formally filed after the time periods established in the law (Castilla y León High Court. Judgment of July 2, 2012)

The appellant was asked to pay a bill. Within a one-month period, it asked the Armed Forces Housing Institute (INVIFAS) to cancel that bill because the VAT charge was incorrect (as the term for charging the tax had expired).

As the INVIFAS refused to correct the bill, the appellant then filed an appeal for cancellation, which was deemed to have been filed late, a decision that was later confirmed by the Castilla y Leon Economic-Administrative Tribunal.

The Castilla y Leon High Court, however, held that the appeal for cancellation cannot be deemed late as the appellant had already submitted to the INVIFAS, an administrative body, within the established term, the grounds for considering that the bill did not comply with the law and that, therefore, the rejection of the appeal for cancellation constituted an infringement of the appellant's right to appeal.

1.6 Administrative proceeding.- Notice served at the premises of the taxpayer's lessee is not valid for notification purposes (Castilla y León High Court. Judgment of July 13, 2012)

The appellant contested an order initiating enforced collection proceedings notified to it at its registered office, arguing that the assessment and the subsequent decisions deriving from it, of which it was not informed, were not correctly notified to it. In particular, all of the tax authorities' actions related to the proceeding, prior to the enforced collection proceeding, had been notified at the lessee's premises and not at the appellant's address or at the place where it performed its activity,

The High Court, accepting the appellant's arguments, overturned the order initiating enforced collection proceedings on the ground that the tax authorities actions breached the legal rules on serving notices and that the tax authorities were required to show the same diligence in serving all notices in relation to the proceeding as that shown when they properly served the order initiating enforced collection proceedings.

2. DECISIONS AND RULINGS

2.1 Corporate income tax.– Foreign-source dividends and capital gains disclosed and taxed at the special 8% rate need not be included in the book income for determining the minimum prepayment (Directorate-General of Taxes. Ruling V1919-12, of October 3, 2012)

The measures recently approved to increase tax collection include a special tax of 8% for income accrued up to November 30, 2012 in relation to investments in nonresident entities that do not meet the requirement established in article 21.1.b) of the Revised Corporate Income Tax Law (specifically, the requirement regarding taxation of the nonresident entity with a tax that is the same or similar to corporate income tax). A minimum tax prepayment has also been established which is calculated by reference to the company's book income.

In this ruling, the Directorate-General of Tax ("DGT") clarified, first, that:

- Financial activities will be deemed economic activities where the taxpayer has the material and human resources to pursue them.

- The interest earned from the placement of cash surpluses deriving from the pursuit of economic activities will also be deemed income from economic activities.

After this clarification, the DGT indicated that taxpayers that pay this special tax rate on such foreign-source income will not have to include that income in the calculation of the tax prepayments for 2012 and 2013, or in the minimum prepayments that are based on book income, as the special tax constitutes the final amount of tax on the income to which it applies.

Although this conclusion refers to the special 8% tax mentioned, it should apply to cases where the special 10% tax is paid for the disclosure of the same type of income in cases where the requirement for the income to come from an economic activity is not met either.

2.2 Personal income tax.– Possibility to earn income from economic activities and salary income in relation to a same entity (Directorate-General of Taxes. Ruling V1827-12, of September 19, 2012)

An individual was hired by a clinic to act as managing director, performing general organization activities without working as a doctor. Under this contract, classified as an employment contract, she received salary income. It was asked whether she could also work as a member of the clinic's medical team and provide services as a self-employed medical professional under a contract for services.

In the DGT's opinion, the compensation for the services performed as a self-employed worker under a contract for services is deemed income from economic activities, and both types of income would be allowed where different types of services generating two types of income are provided to the same entity.

2.3 Personal income tax – Dividend exemption does not apply to income derived from preferred shares (Directorate-General of Taxes. Ruling V1821-12, of September 19, 2012)

The economic and tax treatment of preferred shares is regulated in additional provision two of Law 13/1985, on investment ratios, equity and disclosure obligations of financial intermediaries, which establishes that the income derived from preferred shares will be deemed income obtained for the transfer to third parties of own capital, in accordance with article 25.2 of the Personal Income Tax Law.

It was asked whether this income can benefit from the €1,500 annual exemption provided in article 7.y) of the Personal Income Tax Law. The DGT's reply was that it could not because that article refers to the dividends and shares in income referred to in letters a) and b) of subarticle 1 of article 25 of the Personal Income Tax Law, not those regulated in subarticle 2 of that article.

2.4 Personal income tax.– After the labor reform, the exemption for severance pay is conditional on administrative or judicial conciliation or judgment (Directorate-General of Taxes. Rulings V1803-12 and V1804-12, of September 18, 2012)

In the context of the labor reform introduced by Royal Decree-law 3/2012, new wording has been given to article 7.c) of the Personal Income Tax Law, regulating the exemption for severance pay. Of that new wording, we must highlight the elimination of the second paragraph of article 7.c), which referred to the possibility of applying the exemption if termination of the employment contract took place before the conciliation hearing.

In view of that legislative amendment, the DGT ruled that the exemption only applies to severance pay if there is conciliation or some kind of court judgment (in other words, the so-called "express dismissal" will not be valid). Readers may recall that dismissals carried out between February 12 and July 7, 2012 are not subject to this new obligation in any event.

2.5 Personal income tax.– Deductibility of restoration work on a building used under lease or free of charge (Directorate-General of Taxes. Ruling V1768-12, of September 12, 2012)

Under the personal income tax legislation, taxpayers that perform economic activities can deduct the expenses deriving from the ownership of a building in the proportion in which it is used in the economic activity. In this context, the DGT analyzed the deductibility of restoration work carried out by a taxpayer on a building used under lease:

- In general, renovation work done by the lessee must be recognized as property, plant and equipment and depreciated over its useful life, which will be the term of the lease agreement, where that term is shorter than the economic life of the asset.

- If the property has been assigned to the taxpayer free of charge, however, the work carried out cannot be classified as property, plant and equipment, because the taxpayer is neither the owner nor the lessee. In this case, the work will be classified as a current expense of the business and the expenses may be deducted in the tax period in which they are incurred.

2.6 Personal income tax.– Treatment applicable to attendance fees paid by a company to its directors (Directorate-General of Taxes. Ruling V1738-12, of September 7, 2012)

The DGT analyzed the treatment applicable to the amounts received by the directors to reimburse them for their travel and accommodation expenses. Applying the view that an expense borne on behalf of a third party does not constitute income, the DGT made a distinction between the following cases:

- If the company provides the members of the governing bodies with the means for them to travel to the place where they must perform their activities, that is, the means of transport and, in some cases, accommodation, no income will arise for them as there is no personal benefit for them.

- If the company reimburses the members of the governing bodies for expenses incurred by them to travel to the place where they will provide their services, and they do not evidence that those expenses have been incurred to perform their work, or the company pays them certain amounts for them to freely decide how they will get to the meetings, it will constitute income subject to withholdings.

2.7 VAT.- Modification of taxable amount for cases of insolvency is not incompatible with the modification for nonpayment (Central Economic-Administrative Tribunal. Decision of September 20, 2012)

Under the VAT Law it is possible to modify the taxable amount if the client does not pay its bill. The law also establishes another case of modification of the taxable amount where the taxable person enters an insolvency proceeding. In the case analyzed, the taxable person applied the first mechanism to a case where the client had entered an insolvency proceeding.

The tax authorities, in keeping with the view of the DGT, rejected the modification on the ground that if the debtor is involved in an insolvency proceeding, the modification must necessarily be done under the special procedure established for these cases (and, in particular, within the limited term of one month following the insolvency order).

The Central Economic-Administrative Tribunal held, however, that the two methods are not mutually exclusive, so even if the debtor has been the subject of an insolvency order, the taxable amount can be modified under the method provided for cases of nonpayment, if all the relevant requirements are met. The TEAC highlighted that, in these cases, it is possible to fulfill the requirement to claim the debt from the customer even if the customer is involved in an insolvency proceeding, as this formality can be met by sending a letter though a notary (that is, without needing to file a claim with the court, which is no longer possible in the case of insolvency).

2.8 Collection procedure.- In cases of a shift of liability derived from a penalty, the automatic stay of penalties does not apply (Central Economic-Administrative Tribunal. Decision of September 6, 2012)

In this decision, handed down as a definitive ruling on a point of law, the tribunal analyzed whether or not decisions declaring liability which entail penalties are penalty decisions and, thus, what rules apply to their collection, in particular to petitions for stays of execution if appeals or claims are filed against them.

The Central Economic-Administrative Tribunal held that:

- The liable party is a party subject to tax obligations, which is neither the taxpayer (as it does not perform the taxable event) nor "takes the taxpayer's place," but rather is placed "together" with the main debtor. Thus, it is not the infringing party, which is the one that performed actions or omissions established as infringements in the law.

- Consequently, the declaration of liability is not a penalty proceeding, not even in the exceptional cases in which the law permits penalties to be applied in their context, but rather it is a collection proceeding.

- In this connection, based on the principle of matters reserved for legislation by statute only, in order for the liability to trigger a penalty, the facts must have been defined and classified as an infringement by the lawmaker.

- In short, the liable party is defined as a *supplementary* debtor, whose link to the amounts claimed will be determined by the simultaneous existence of two events: one, the performance of the taxable event by the taxpayer and the other, the existence of the facts determined in the law as giving rise to liability.

- In view of how the liable party is defined, it must be concluded that liability is a vehicle to guarantee the tax credit, the payment of which the lawmaker has tried to secure or preserve by imposing the payment obligation on a third party in the event of default by the principal debtor, such that the possibility, in certain liability scenarios, of including the amount of penalties in the scope of that liability cannot

distort the nature of that vehicle (as a guarantee), nor can the exceptional automatic stay of payment, which is specific only and exclusively to penalties, apply to all of the elements included in the liability decision (tax payable and interest).

- In other words, the law does not penalize the liable party but merely claims from it the payment it has an obligation to make, pursuant to a specific legal provision, through a specific collection proceeding separate from the penalty proceeding.

- It transpires from the above that in order for leave to be given to proceed with the petition for a stay, it is necessary to contend and prove specifically that the enforcement of the contested decision would cause harm that would be costly or impossible to remedy, attaching the supporting documents and means of proof to evidence this.

3. LEGISLATION

3.1 Anti-fraud law

On October 30, 2010 the Official State Gazette published Law 7/2012, of October 29, 2012, amending tax and budgetary legislation and adapting financial legislation to step up proceedings to prevent and fight fraud.

The changes introduced by that Law have been discussed in detail in our tax update 8/2012. We are attaching a link to that update for more information.

http://www.garrigues.com/es/Publicaciones/Novedades/Documents/Novedades-Fiscal-8-2012.pdf

One of the measures established in that law is the obligation to disclose the assets and rights located abroad over which the taxpayer has the power of disposal. According to public reports, on November 15, 2012, the Council of Ministers approved the royal decree implementing this particular aspect, but on the date of writing, it has not yet been published in the Official State Gazette.

3.2 Law on write-down and sale of real estate assets of the financial sector

On October 31, 2012, the Official State Gazette published Law 8/2012, of October 30, 2012, on the write-down and sale of real estate assets of the financial sector, which entered into force on the same day it was published.

From a tax standpoint, the law merely reiterates the changes already introduced by Royal Decree-law 18/2012, of May 11, 2012, on the write-down and sale of real estate assets of the financial sector, which was a step forward in the reform initiated by Royal Decree-law 2/2012, of February 3, 2012.

In particular, the key tax reforms are as follows:

- Tax neutrality for contributions of assets by credit institutions to asset management companies

  Transfers of assets and liabilities made in the context of the provisions of Law 8/2012 in order to set up asset management companies can be carried out under the tax neutrality rules established in chapter VIII of title VII of the Revised Corporate Income Tax Law, even though they might not fit within any of the transactions defined in its articles 83 or 94.

- Article 108 of the Securities Market Law on the transfer of asset management companies and credit institutions

  The subsequent transfer of the securities received as a consequence of the formation of those companies created to manage real estate assets will not be subject to transfer tax.

  This exception to liability for transfer tax is also established for the transfer of securities in the credit institutions affected by integration plans regulated in Royal Decree-law 9/2009.

- Exemption for income from the transfer of certain real estate

  In order to boost the real estate market, the law has introduced a partial exemption from corporate income tax, personal income tax and nonresident income tax on 50% of the income and capital gains from the transfer of urban real estate acquired for valuable consideration from May 12 to December 31, 2012, where certain requirements are met and subject to specific rules on each of those taxes (for nonresident income tax purposes, it is not expressly stated that the assets had to be acquired for valuable consideration).

  For all three taxes, the exemption cannot be taken where the transferor and the acquirer are spouses or relatives, direct or collateral, by blood or affinity, up to and including the second degree; and where the real estate is acquired from or transferred to an entity with which the taxpayer or any of the persons mentioned above is in any of the positions established in article 42 of the Commercial Code, regardless of their residence or of the obligation to file consolidated financial statements.

3.3 Change to the modules under the simplified VAT method for 2012 and possibility of waiving that method

On October 24, 2012, the Official State Gazette published Order HAP/2259/2012 which includes the revision of the modules under the simplified VAT method for 2012, in order to update their amount in keeping with the latest VAT rate increases.

In addition, a special period is established for waiving the use of the objective assessment methods for personal income tax purposes and of the special simplified VAT method. This waiver can be made from October 25 to November 30, 2012, and will take effect

starting on January 1, 2013, in the case of the objective assessment method for personal income tax purposes, and starting on October 1, 2012, in the case of the special simplified VAT method.

Taxable persons that waive the simplified VAT method for the fourth quarter of 2012 must file a final tax return, "Value added tax. Standard and simplified method" (form 371), where they will specify the transactions carried out in the fourth quarter of 2012 in the "Activities under the standard method" section, and the transactions carried out under the simplified method in the first three quarters of 2012 in the "Activities under simplified method" section.

4. OTHER NEWS

4.1 Special Tax Return: Second report by the Directorate-General of Taxes

On October 11, 2012, a second report was published by the DGT to reply to various questions relating to the voluntary disclosure procedure derived from filing the special tax return regulated in the first additional provision of Royal Decree-law 12/2012.

Among other issues, the DGT clarifies that in the case of co-ownership of assets or rights, a special return will have to be filed by each co-owner for the portion relating to its ownership interest. However, if, in accordance with tax legislation, the unreported income must be attributed to only one of the owners, that owner can report all the assets in its special tax return (a common scenario in the case of community property matrimonial arrangements).

The DGT also highlights that in the case of transformed assets, the losses originated in open years firstly reduce to zero the acquisition value of the original goods, and only the excess will reduce the gains from open years.

Regarding the rest of the principles governing the special tax return, the DGT has ruled out the possibility of using this return to disclose attributed income (from real estate, under the fiscal transparency regime or from collective investment undertakings in tax havens). However, it is worth noting that in the DGT's opinion, it will not be necessary to attribute income under the fiscal transparency regime or from collective investment undertakings in tax havens where the assets have been transferred before December 31, 2010, and the income has been reinvested, before that date, in other assets that are reported in the special tax return.