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New Corporate Income Tax Regulation

Royal Decree 634/2015, of July 10, 2015, approving the Corporate Income Tax Regulations (the "**RIS**") was published in the Official State Gazette on July 11, 2015. What has actually been approved is a new set of regulations to adapt and update the former regulations to the new legislation in recently approved Corporate Income Tax Law 2014, of November 7, 2014 (the "**LIS**").

Below is a summary of the main new features introduced by this royal decree (which entered into force on July 12, 2015 and will apply to tax periods commencing on or after January 1, 2015, with some exceptions which are indicated in the relevant sections below).

1. Asset-holding entities

The LIS contains the first reference made in the corporate income tax legislation to asset-holding entities (entities that do not engage in an economic activity), defining them as entities at which over half of their assets consist of securities or are not used in an economic activity.

To determine whether an entity falls within this category, regard will be had to the value of the assets and securities not used in a business activity, which will be the average figure obtained from the entity's quarterly balance sheets for the year or, if the entity is the parent company of a group within the meaning of article 42 of the Commercial Code, regardless of the residence and of the obligation to prepare consolidated financial statements, from the consolidated balance sheets.

In this respect, the RIS establishes that "*to determine whether or not an entity has asset-holding status in the tax periods commencing before January 1, 2015, account shall be taken of the aggregate sum of the annual balance sheets of the tax periods relating to the time that the holding was owned, up to the limit of those commenced before January 1, 2009, subject to evidence to the contrary.*" This regulatory provision increases the technical complexity already existing in the LIS when it comes to determining the asset-holding status of an entity.

2. Tax base

The main elements are:

(i) Timing of recognition: a similar procedure to the one in the former regulations is established for cases where the taxpayer uses a timing of recognition method for accounting purposes other the accrual basis.

(ii) Amortization/depreciation: the implementing regulations applicable to amortization/depreciation are updated to reflect the National Chart of Accounts approved by Royal Decree 1514/2007, of November 16, 2007, after the former regulations, which has rendered the references to certain rules unnecessary (e.g. the definition of "useful life" or the treatment of intangible assets with a defined useful life).

Notable elements are the elimination of the treatment of technical facilities and of the preexisting provision that different amortization/depreciation methods cannot be applied simultaneously or successively to the same asset, plus the option of submitting special amortization/depreciation plans at any time within the amortization/deprecation period of the asset (the former regulations established a period of three months after the start of the amortization/depreciation period).

(iii) Hedging credit risk at credit institutions: the special tax deduction regime is retained on the same terms as were in the previous legislation, and its scope of application has been extended to take in the securitization funds referred to in title III of Law 5/2015, of April 27, 2015, to encourage enterprise finance, in relation to the deduction of the valuation adjustments for the impairment of debt instruments valued at amortized cost.

(iv) Advance pricing of expenses related to scientific research or technological innovation projects: if another proposed value is approved which differs from the one initially submitted, it has to be accepted by the taxpayer. The limit on the validity of the Decision has been eliminated (before it could not be longer than 3 years).

(v) Advance pricing agreements or advance characterization and pricing agreements for income from certain intangible assets:

- The provision has disappeared under which the applicant could be instructed, where necessary, to correct errors or complete the application, for which it had 10 days and the proceedings could be ended without the application being deemed to have been filed if that demand had not been fulfilled.

- It is clarified that if another pricing proposal is approved which differs from the one initially submitted, it must be accepted by the taxpayer.

(vi) Transitional rules on the deduction of financial goodwill in relation to the investments made before January 1, 2015: certain information must be provided in the fiscal years in which the deduction is made.

3. Related party transactions

The most important new element included in the RIS is the introduction of country by country reporting requirements, in line with the latest work performed by the OECD on Action 13 within the BEPS project. The characteristics of this new requirement are summarized below:

(i) It applies to any Spanish-resident entity which is the parent company of a group (as defined in article 42 of the Commercial Code), and is not also the subsidiary of another, resident or nonresident entity.

The requirement also applies to Spanish resident entities which are directly or indirectly the subsidiaries of a non-Spanish resident entity which is not also the subsidiary of another, or to permanent establishments of nonresident entities, meeting any of the tests listed in the RIS and which make up for absence of disclosure scenarios.

(ii) Any Spanish-resident entity which is part of a group subject to reporting requirements must notify the tax authorities, before the end of the tax period to which the information relates, of the identity and the country or territory of residence of the entity required to prepare that information.

(iii) The information must be submitted within up to 12 months after the end of the tax period and on the form approved for the purpose.

(iv) The requirement applies where the net revenues of all the persons or entities forming part of the group in the 12 months before the beginning of the tax period is equal to or above €750 million.

(v) The information that must be reported, in relation to the parent company's tax period, on an aggregate basis for each country or jurisdiction, and in euros, will be as follows:

- The group's gross revenues, broken down into those obtained with related parties or with third parties;
- Earnings before corporate income tax (or an identical or similar tax);
- Corporate income tax (or an identical or similar tax) satisfied, including the withholdings paid;
- Corporate income tax (or an identical or similar tax) that has fallen due, including withholdings;
- Amount of the capital stock figure and other shareholders' equity existing on the end date of the tax period;
- Average headcount;
- Property plant and equipment and investment properties other than cash and collection rights;
- List of resident entities, including the permanent establishments, and the primary activities carried on by each of them; and
- Any other information considered necessary and an explanation, if needed, of the data included in the information.

(vi) The country by country report will be required for tax periods beginning on or after January 1, 2016.

It must be highlighted, lastly, that, according to the Preamble to the RIS, the country by country report is an instrument that may be used for assessing the risks in the transfer pricing policy of a corporate group, but may not under any circumstances serve as a basis for the tax authorities to make pricing adjustments.

It does not seem either that the requirement to include certain quantitative information on the corporate income tax return form (previously provided on page 20) will be eliminated.

In relation to the specific documentation requirements to support that the related party transactions performed have been priced at their market value, the existing double set format has been retained, including the documentation on the group to which the party with tax obligations belongs and the documentation on the taxpayer, although a number of new requirements have been set out concerning the contents of both.

Moreover, it has been expressly accepted that generally accepted pricing methods and techniques other than the "usual" transfer pricing methods can be used (i.e. discounted cash flow methods). If this is the case, all the necessary information on which they are based must be reported and support must be given for the reasonability and consistency of the assumptions used.

Elsewhere, a definition is provided of the contents of the simplified documentation for individuals or entities having net revenues below €45 million, and small-sized entities are given the option to fulfill that documentation requirement on a "standard document" specially prepared by the Ministry.

Lastly, under the "new" documentation requirements laid down for individuals or entities having a net revenues figure equal to or higher than €45 million, the specific information and documentation established in article 15 and article 16 RIS will be applicable for the tax periods beginning on or after January 1, 2016. In the tax periods beginning in 2015, these individuals and entities will be subject to the documentation requirements established in article 18, article 19 and article 20 of the Corporate Income Tax Regulations, approved by Royal Decree 1777/2004, of July 30, 2004.

Significant amendments are also made in relation to performance of the comparability analysis:

(i) It includes tacit leave to recharacterize related party transactions, because, as a requirement to perform the comparability analysis, it says it will be necessary to take into account the relationships between the related individuals or entities and the terms and conditions of the transactions to be compared according to the nature of the transactions and the conduct of the parties.

(ii) The existence of losses, the influence of the decisions of public powers, the existence of location savings, and assembled workforce or group synergies are all expressly mentioned among the circumstances to be taken into consideration when assessing the factors determining comparability.

(iii) It is expressly accepted that statistical methods may be used to reduce the risk or error caused by comparability defects, although no mention is made of what type of methods, or whether a certain point in the range determined by their application must be used.

There are also considerable changes in relation to the related party examination system:

(i) In line with the amendments made in article 18 LIS, the term "examination of the normal market value" has been replaced by "examination of related party transactions" and "value adjustment", by "adjustment made", which corroborates the power to examine not only the pricing of the transactions, but also the nature itself of the transactions. Also, all references to the option of requesting a contradictory expert appraisal have disappeared, to implement the provisions in article 18 LIS.

(ii) There is no longer any mention of incompatibility between an appeal for reconsideration and an economic-administrative claim in cases where no agreement existed between the various related parties or entities affected by a provisional assessment.

(iii) Express acceptance has been included of the tax authorities having to make a bilateral adjustment on their initiative, although a new route has been opened up for the taxpayer concerned to make the adjustment through a self-assessment.

In relation to the secondary adjustment, and with a view to preventing that adjustment being applied, article 18.11 already allowed the repatriation of funds in respect of the pricing difference. For this purpose, it is established that the taxpayer must evidence that it has repatriated that amount before the relevant assessment is issued. No mention is made, however, of the procedure that would have to be implemented to do this or what types of evidence will be allowable.

Amendments are also made to the advance pricing agreement rules:

(i) The option to request those agreements has been extended in relation to the estimated income in respect of transactions performed by a taxpayer with a permanent establishment abroad, on condition it is provided for in an applicable tax treaty.

(ii) The option to request agreements of this type in relation to the application of thin capitalization ratios has been removed.

(iii) It has also done away with the references in the previous Regulations to the ability to correct errors at the beginning of the proceeding and to the need to found the failure to admit the application for consideration.

(iv) Critical assumptions conditioning the ability to apply the agreement have been added among the contents of the agreement, although this was already being done in practice.

The following matters are worth highlighting in relation to transactions performed with tax havens:

(i) The non-requirement for documentation in transactions performed with the same individual or entity involving a combined amount not exceeding €250,000 has been eliminated.

(ii) An exception to this obligation has been made for the transactions carried out with entities fulfilling the following two requirements: a) they must reside in an EU member state or in states in the European Economic Area with which there is an effective exchange of information on tax matters; and b) the taxpayer must evidence that the transactions were for valid economic reasons and that those individuals or entities carry on economic activities.

Lastly, the royal decree also amends (final provision one) the Regulations on mutual agreement procedures concerning direct taxation, approved by Royal Decree 1794/2008, with the aim to give authorization to AEAT, the Spanish tax agency, as the competent authority for handling these procedures where they are related to the application of the EU Arbitration Convention, in addition to any based on tax treaties, where they relate to the application of the articles on business profits with a permanent establishment and associated enterprises. The mutual agreement procedures over which powers are shared will be coordinated by the Directorate-General of Taxes.

4. Tax credits

As a result of the repeal for fiscal years beginning on or after January 1, 2015 of the tax credits for environmental investments, the tax credit for the reinvestment of extraordinary income and the tax credit for the reinvestment of income, these tax incentives are not addressed in the new regulations.

5. Special regimes

The following special regimes are maintained in the new regulations without any material amendments: (i) the tax regime for certain financial lease agreements, (ii) the foreign-security holding entities regime, and (iii) the political parties regime.

The regime for shipping entities based on tonnage is also maintained on the same terms as in the former RIS, except for the provisions concerning the application for, or extension or waiver of, this special regime, which, under the former rules, had to be filed at least three months before the beginning of the tax period and which can now be filed at any time before the end of the tax period.

The most prominent elements concerning the other special regimes are as follows:

5.1 Obligations of Spanish and European economic interest groups and of unincorporated joint ventures

The RIS amends the contents of the information to be supplied together with the corporate income tax return by these entities in keeping with the amendments introduced by the LIS. The amendments involve the following new features:

(i) The persons or entities to which joint venture's income is attributed are specified and information must be provided on: those who hold the inherent rights or the status of partner or member company who are resident in Spain or not resident with a permanent establishment in Spain (this last-mentioned case was one of the new features introduced by the new LIS).

(ii) Elsewhere, the definitions of the amounts that must be attributed to the partners/members in accordance with the new LIS are updated. Thus, in the new regulations the following amounts to be attributed have been expressly added to the items already set out in the former regulations: (i) the net finance costs not deducted by the entity, (ii) the capitalization reserve not used by the entity, and (iii) the leveling reserve for decreasing or increasing the taxable income.

5.2 Consolidated tax regime

The RIS adapts the procedural obligations under the consolidated tax regime to the new delineation of the scope of consolidation of the tax group introduced by the LIS.

The main adaptations arise from the new legislation introduced by the new LIS which permits the consolidation of Spanish entities without the need for a common Spanish parent entity, provided that the nonresident entity owning an interest in all of them does not reside in a tax haven and meets the requirements to be considered a parent company in accordance with the rules laid down in this respect. This determined the need to include new procedural obligations in the RIS, namely:

- The election to apply the consolidated tax regime will be notified to the Provincial Tax Office for the tax domicile of the representative entity (no longer of the parent company) or to the Regional Inspection Offices or the Large Taxpayers Office where the representative entity has been assigned to them.

- In the notice of the election to apply the special regime, if the parent company is not resident in Spain, it is necessary to identify the parent company of the tax group and to include the document in which the representative entity is appointed.

- It is also mandatory to disclose the percentage of voting rights held by the parent entity in each and every one of the entities making up the tax group.

- In a simply formal change, references to the parent entity are replaced in the new RIS with references to the representative entity when it comes (i) to the express statement of compliance with the requirements to apply the special regime which must be made when the special regime is elected, and (ii) to the entity to be notified by the tax authorities of the tax group number that has been allocated.

Lastly, it is worth noting that the references to the powers to inspect tax groups that existed in the former regulations are eliminated in the new RIS and are replaced with a general reference to the organic structure rules of the State Tax Agency that may apply.

5.3 Regime applicable to the restructuring transactions

The LIS introduced as a new feature the configuration of the tax regime for restructuring transactions as a standard regime for transactions of this type (no longer as a special regime). Accordingly, this regime will apply automatically unless the taxpayer expressly indicates otherwise and the need to elect to apply it has disappeared. However, the LIS laid down the obligation to notify the tax authorities of the performance of the transactions to which this regime will be applied.

The disappearance of the election to apply the restructuring transactions regime has generally led to a reduction in the RIS of the procedural obligations for the taxpayer.

As for the notification of the performance of restructuring transactions that must be provided to the tax authorities, the RIS establishes as follows:

- It will be provided, as a general rule, by the transferee, unless it is not resident in Spain, in which case it will be provided by the transferor.

  If both the transferee and the transferor are not resident in Spain, the notification will be provided by the shareholders of the transferor, if they are resident in Spain. Otherwise, the notification will be provided by the transferor.

- The time limit for providing the notification continues to be three months following the date on which the public deed documenting the transaction is registered. However, in transactions in which the transferee and transferor are not resident in Spain, the notification may be provided within the period established for the filing of the returns and self-assessments of the shareholders of the transferor, provided that they are resident in Spain. Otherwise, the three-month period will apply.

6. Management of the tax

The new regulations maintain the same terms as were contained in the former regulations (except for certain references to articles and legislation) concerning (i) the index of entities, (ii) the refund of the tax and (iii) the obligations to deal with external institutions for the filing and management of returns.

In addition, the terms in the regulations on the obligations to withhold tax on cash payments and payments in kind are generally the same as in the former regulations (except for certain references to articles and legislation). However, when it comes to the base for calculating withholdings, the RIS clarifies that:

- In the case of the lease or sublease of urban real estate, the withholding base will consist of all of the items paid to the lessor, excluding VAT.

- In the case of prizes from lotteries or bets which, due to their amount, are subject to and not exempt from the special tax on certain lotteries and bets, the withholding will be made on the amount of the prize subject to and not exempt from the tax.

As a general rule, the withholding rate will be 19% (with the exceptions mentioned below regarding the year 2015) except when it comes to:

- Income from the licensing of the image rights or the consent or authorization to use it, which is kept at 24%; and

- Prizes from lotteries and bets which, due to their amount, are subject to and not exempt from the special tax on certain lotteries and bets, which will be 20%.

As a result of the transitional regime in the LIS and the amendments introduced by Royal Decree-Law 9/2015, of July 10, 2015, on urgent measures to reduce the tax burden on personal income taxpayers and other economic measures, the standard 19% withholding rate will be:

- 20% from January 1, 2015 to July 11, 2015.

- 19.5% from July 12 to December 31, 2015.

7. Conversion of deferred tax assets into receivables claimable from the public treasury

The royal decree-law introduces into the RIS the procedure for the offset and payment of deferred tax assets when they are converted into receivables claimable from the public treasury.

Let us recall that these deferred tax assets must relate to adjustments in respect of impairment losses recorded on receivables and other assets arising from the potential bad debts of unrelated debtors, not owed by public law entities, as well as in respect of contributions to employee welfare systems and, as the case may be, pre-retirement.

The conversion of the deferred tax assets into a receivable claimable from the tax authorities will take place at the time of filing of the corporate income tax self-assessment for the tax period in which the following circumstances occur:

- The taxpayer records losses per books in its audited financial statements already approved by the relevant body;

- The entity is subject to liquidation or an insolvency order rendered by a court.

- Any deferred tax assets arising from the right to offset tax losses in subsequent years will be converted into a receivable claimable from the tax authorities where they result from inclusion in the tax base of impairment losses recorded on receivables or other assets

arising from potential bad debts of debtors, as well as provisions or contributions to employee benefit systems and, as the case may be, pre-retirement, which gave rise to the deferred tax assets.

Following this conversion, the taxpayer may elect (i) to request payment of the amount concerned from the tax authorities or (ii) to use the receivables to offset any other central government tax debts that the taxpayer may generate after the conversion.

Therefore, depending on the chosen option:

- The request for payment will be made on the self-assessment form and will be subject to the rules applicable to the refunds set out in the legislation for each tax (article 31 of the General Taxation Law) on which no late-payment interest may accrue.

- If the taxpayer elects to use the receivable claimable from the tax authorities to offset other debts, it must submit the relevant request to the body responsible for handling it, for each debt sought to be offset. This request must contain the following particulars:

    - Identification of the tax debt requested to be offset, indicating at least its amount and item. The date of expiration of the payment period must also be indicated in the case of debts with a voluntary payment period.

    - Identification of the self-assessment in which the receivable claimable from the tax authorities that is sought to be used for offset is generated.

    - Statement by the taxpayer indicating that it has not requested the payment of the receivable and has not requested its use for offset in the same amount against other tax debts.

The request may be submitted in relation to debts generated after the conversion and will not preclude requests to defer or split the payment of the remaining debt.

The decision on the request must be notified within 6 months. Where the RIS is silent, the provisions governing the offset of debts in the General Revenue Regulations will apply.

Lastly, it is established that the power to conduct this proceeding and issue the related decision will be established by the relevant specific organization order.

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