GARRIGUES

bulletin TAX

1-2014
January, 2014

The General Tax Law provides statutes of limitations that apply to tax authorities and taxpayers alike. The tax authorities thus have only four years to assess or claim the payment of assessed or self-assessed debts, and taxpayers have the same period to apply for and obtain refunds and reimbursements of the costs of guarantees.

The National Appellate Court has had the opportunity to examine whether this statute of limitations applies to a refund requested by the taxpayer and already recognized by a final decision; in other words, not to the actual right to apply for the refund, which is four years since the payment to which the requested refund relates was made, but to the taxpayer's right, where that refund has already been applied for and recognized, to have the tax authorities enforce the decision recognizing the refund.

The Court, in a recent judgment rendered on December 19, 2013, which we discuss below, made a distinction between the application for a refund and the enforcement of a refund already recognized in a final decision or judgment, and concluded that the General Tax Law does not provide a statute of limitations for this second case. That seems reasonable considering, as the National Appellate Court recalls, that it is the tax authorities who must properly enforce administrative decisions themselves without the interested party having to request this.

Thus, the Court applied criteria similar to those prevailing for court decisions, which do not have their own limitation period, as the Supreme Court has stated on repeated occasions.

1. JUDGMENTS

1.1 Corporate income tax.- If the investee cannot be reviewed, the investment impairment provision recorded by the parent in respect of that subsidiary cannot be questioned (National Appellate Court. Judgment of September 19, 2013)

An entity had recorded an investment impairment provision. The impairment had arisen from the subsidiary recording another provision. Specifically, the subsidiary had experienced a decrease in equity by recording a provision for securities that had been revalued in a merger carried out subject to the special regime. The tax inspectors considered that the provision recorded by the subsidiary was not deductible and, therefore, that the provision recorded by the parent was not deductible either.

The appeal against the assessment in the notice issued to the investee was upheld because it was statute-barred, and the National Appellate Court held that, if the provision recorded by the subsidiary must be allowed to be deducted as a result of the statute of limitations, the provision recorded by the parent, the reason for which was the provision at the subsidiary, cannot be questioned either.

1.2 Corporate income tax.- Review of tax credits and losses from statute-barred years (Supreme Court. Judgments of December 5 and 9, 2013; and National Appellate Court. Judgment of September 26, 2013)

These judgments analyzed the much discussed topic of whether tax losses and tax credits generated in statute-barred years could be reviewed. The following elements of those judgments are worth noting:

(i) Firstly, the Supreme Court, in its judgment of December 5, 2013, affirmed that the debate over the review of tax credits is different from that relating to tax losses, because the legislation to be applied has not always been the same.

Thus, in relation to the review of tax losses from statute-barred years (and offset in open years), the Court recalled that such a review is allowed by the wording of article 23.5 of the Corporate Income Tax Law (introduced effective on January 1, 1999 and subsequently amended effective on January 1, 2002), while the review of tax credits from statute-barred years (and used in open years) was not given the same treatment by the lawmakers until General Tax Law 58/2003, of December 17, 2003 ("LGT"), which broadened the rules on the offset of tax losses (article 106.4) to apply to tax credits.

Therefore, tax credits that are statute-barred can only be reviewed if they have been used in the fiscal years starting on or after the entry into force of the new LGT, that is, on or after July 1, 2004.

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In conclusion, the Court ruled that some tax credits reported in fiscal years 1996 through 1999 and used in 2001 could not be reviewed once they are statute-barred, even if the review is carried out after the entry into force of the LGT. That conclusion was based on the principle that tax law is not retroactive and on the vested rights of the Court itself, set forth in its judgment of November 22, 2012.

Regarding this same issue, the National Appellate Court (in a judgment of September 26, 2013, as in previous ones) also disallowed a quantitative or qualitative review of tax credits, if the review was not performed in the proper time with respect to the periods in which they were generated.

(ii) Moreover, the Supreme Court, in its judgment of December 9, 2013, tried to determine the correct interpretation of that same article 23.5 of the Corporate Income Tax Law according to the legislative changes that had taken place. In this regard:

- The Court affirmed that following the introduction of that subarticle 5, it was no longer sufficient to claim that the fiscal year in which the tax losses arose had become statute-barred, since supporting documents are needed and they must be sufficient.

- It remains unknown whether, after the tax losses have been reported, the tax authorities can inspect the statute-barred year and rectify or eliminate the tax losses, and if so, to what extent.

- Basing itself on its previous judgments of November 6 and 14, 2013, the Court held that:

  - The taxpayer must prove, with documents, both the amount of the tax losses to be offset and also their origin.

  - Once the taxpayer has evidenced that the tax losses recorded in the statute-barred year match those offset in the open year, if the tax authorities argue that the offset is unjustified, it is they who must substantiate the difference between both parties' views.

  - However, this analysis by the tax authorities must stem from a simple analysis of the relevant accounting and tax documents, they cannot perform assessment operations (such as, for example, to conclude that a transaction was performed with the aim of tax fraud) which were not performed when the fiscal years concerned were still open for review.

  - The Court stressed, moreover, that not even the tax authorities could have performed the investigation at the right time, because a finding of tax fraud requires an express decision in an ad hoc proceeding and that cannot be done implicitly, as occurred in this case.

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1.3 Personal income tax.- Referral for a ruling of unlawfulness in relation to the requirement under the previous Personal Income Tax Regulations regarding the application of the regime for inbound expatriates (Supreme Court. Judgment of October 16, 2013. Official State Gazette of December 19, 2013)

The Court analyzed a referral for a ruling of unlawfulness in relation to article 111.b of Royal Decree 1775/2004, of July 30, 2004 (Personal Income Tax Regulations in force before the current Regulations), due to the potential lack of coverage in article 9.5 of Legislative Royal Decree 3/2004, of March 5, 2004 (Revised Personal Income Tax Law in force before the current Law). In that article of the Regulations, relating to the regime for inbound expatriates, it was required for the taxpayer not to obtain income characterized as obtained through a permanent establishment located in Spain.

The Supreme Court considered that the Personal Income Tax Law establishes a general principle, consisting of creating an option for those who come to have their principal residence in Spain because they are sent to Spain, whereby they can elect to be taxed for personal income tax or, alternatively, for nonresident income tax, provided they meet a number of requirements that the Law lays down. This special regime is commonly known as the "inbound expatriates regime".

Nonetheless, the Law does not refer anywhere to exceptions to the option, for those who obtain income through a permanent establishment, unlike what is stated in article 111.b) of the Regulations. The Court concluded, therefore, that this subarticle of the Regulations is contrary to the law.

Readers are reminded, in any case, that the current Personal Income Tax Law (Law 35/2006, of November 28, 2006) has included that requirement in article 93.b.

1.4 VAT.- Definition of independent economic unit for VAT purposes (Supreme Court. Judgment of November 28, 2013)

In this case, the Court analyzed the subjection to VAT of a spin-off in which an entity transfers to two different entities the physical assets, permits and rights that enable them to conduct the activity (gambling operation) in which the entity performing the spin-off was engaged.

As it had already done in a judgment of June 19, 2013, the Supreme Court confirmed the National Appellate Court's view, by holding that in order for the transferred assets to constitute an independent economic unit and, thus, for the transaction not to be subject to VAT, it must include all the assets that are essential, necessary and sufficient to carry on the economic activity in question thereby enabling the acquirer to continue with that activity "at its destination," while it is not necessary to transfer all of the assets that are used (that is, even if the transferred activity was not a separate unit "at its origin").

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1.5 Inheritance and gift tax.- 95% reduction for family businesses (Supreme Court. Judgment of December 16, 2013)

To apply the 95% reduction to the tax base established for family business succession, among other requirements, the taxpayer or any person in the family group must effectively perform management functions at the company, in exchange for which they receive remuneration accounting for more than 50% of their total income from business or professional activities and personal work.

In the case analyzed, the functions were performed not by the deceased but by one of his offspring, who met the above requirement in the fiscal year of his death (between January 1 and the date of death) but not the year before.

The tax authorities considered, pursuant to the DGT Ruling 2/1999, of March 23, 1999, that where the deceased was the one that performed the management functions, that requirement had to be met by reference to the period between January 1 of the year of death and the date of death. However, if the person who performed the management functions was not the deceased but any other member of the family group, the data relating to the year before that of the death should be taken into account.

In an opposite view, the Supreme Court held that to confirm whether the requirements for applying the reduction in question are met, regard must be had to the date on which inheritance and gift tax falls due, and that you cannot refer to other personal income tax periods just because the requirement must be met by different taxpayers. In this regard, even though the person who performed the management functions was one of the heirs, it is still the year that commenced in the year of the death that counts.

The main problem in practice is how an instant tax, such as inheritance and gift tax, fits in with other periodical taxes, such as personal income tax and wealth tax, which are used to determine whether the requirement for applying the reduction is met.

1.6 Inheritance and gift tax.- Household furnishings are calculated including the value of any that have been bequested (Extremadura High Court. Judgment of September 17, 2013)

In inheritance cases, inheritance and gift tax legislation requires household furnishings to be reported, which, unless proved otherwise, will be 3% of the value of all the assets left by the decedent.

The Extremadura High Court ruled in this judgment that when calculating the household furnishings, the 3% rate must be applied to the value of all the goods included in the decedent's estate, without discounting the value of any that have been bequested.

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1.7 Municipal tax on increase in urban land value.- The actual increase in the value of land prevails over the result of applying the calculation rules contained in the legislation (Cataluña High Court. Judgment of July 18, 2013)

The municipal tax on the increase in urban land value (known as "municipal capital gains tax") is calculated on a theoretical increase in value of the transferred land, determined by reference to the land's cadastral value and to the period elapsing since its acquisition.

This case involved an appeal against a local law regulating the tax for a certain municipality, in which the appellant relied on the principle of non-confiscation to contend that the tax should not be able to be claimed where there is not an actual increase in land value.

The Court confirmed this submission and stated that where it is evidenced that there has not been any increase in real economic terms, the taxable event for this tax does not take place and, therefore, the tax cannot be claimed. It also held that where there is an increase in the value of the land, the tax will be calculated on the actual increase in the value, which must prevail over the amount determined under the rules on the tax.

Nonetheless, the Court dismissed the appeal, on the ground that such circumstance must be analyzed in the specific case and not, as the claimant wanted, by judging the local law directly.

1.8 Administrative proceeding.- Notice must be served at the address of the entity's legal representative appearing in the case file before using the public notice procedure (Castilla-León High Court. Judgment of October 18, 2013)

In the case analyzed, the taxpayer had filed an appeal against an enforced collection order, claiming that it had not been served notice of the denial of the extension which triggered the proceeding. Apparently, the authorities had unsuccessfully attempted to serve notice of that denial and then had used the public notice procedure.

The Court held that the tax authorities had failed to provide diligence by attempting to serve notice of the denial of extension only at the appellant's tax domicile and then directly using the public notice procedure, while according to the case file, it was extraordinarily easy to obtain the legal representative's address.

1.9 Inspection proceeding.- Tax authorities cannot inspect and find tax fraud in transactions carried out in a statute-barred year (National Appellate Court. Judgment of November 21, 2013)

The tax inspectors disallowed the deduction of some finance costs as a result of a finding of tax fraud in a transaction that was at the origin of the debt, even though that transaction had been carried out in a statute-barred year.

The National Appellate Court, in keeping with its judgments of January 24 and July 24, 2013 to which it referred, and without analyzing whether or not the transaction had been carried out with fraud, held that it was not possible, in the context of the inspection of

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open years (in which the interest was deducted), to review a transaction carried out in a prior year that was already statute-barred.

The Chamber considered that a finding of fraud resides, and must be characterized as such, in facts, acts or transactions that were carried out with fraud, and that it was not legally allowable to project the fraud only onto the legal and economic consequences resulting from the performance of those acts or transactions.

1.10 Inspection proceeding.- The same facts cannot be inspected twice (National Appellate Court. Judgment of October 24, 2013)

The appellant had undergone a limited review in relation to a tax credit for reinvestment that it had reported and taken. The tax authorities then inspected the same tax credit again.

The tax authorities contended that the purpose of the first inspection was simply to identify that the amounts reported in the tax returns were mathematically correct, without analyzing the requirements for taking the tax credit, and that the second inspection was carried out to verify fulfillment of the substantive requirements for taking the tax credit. The Chamber considered, however, that it must reasonably consider that the first inspection covered all elements of the disputed tax credit.

In this regard, the National Appellate Court held that the "new element" to which article 140 of the General Tax Law refers, which allows a subsequent proceeding to be commenced, must be deemed to refer to supervening facts and circumstances that alter how the tax is determined in some relevant way but not to facts which the tax authorities identify by starting over again merely because they made more of an effort or a more in-depth analysis in the second proceeding than in the first one.

1.11 Enforcement proceeding.- The enforcement of an administrative decision is not subject to a statute of limitations (National Appellate Court. Judgment of December 19, 2013)

After a refund application had been recognized in a final administrative decision, in view of the delay in enforcing that decision, the taxpayer requested its enforcement. The Central Economic-Administrative Tribunal ("TEAC") then denied the refund on the ground that the right to request the enforcement of the decision was statute-barred because more than four years had elapsed between the date of the final decision and the date the enforcement was requested.

In a novel interpretation, the National Appellate Court ruled that the right to the refund of a self-assessed amount recognized in a final decision by the TEAC itself is not subject to a statute of limitations. The Court thus distinguished between the right to apply for a refund (for which the limitation period is established in article 66.d) of the LGT) and the period for making the refund once that right has been recognized (on a timely basis).

The Court added that no other conclusion was possible in a case in which the tax authorities should have enforced the decision themselves.

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1.12 Penalty proceeding.- The penalty base established in art. 191.6 LGT cannot include any portion of the tax deficiency paid over at a later date (National Appellate Court. Judgment of November 21, 2013)

According to the LGT, in order to apply the provisions on late-filing surcharges, the late tax returns must set out the assessment period to which they refer and contain only the data relating to that period. Accordingly, the Law establishes that the failure to make timely payment of the taxes or prepayments included or adjusted by the taxpayer in a late self-assessment without fulfilling the aforementioned requirements will always constitute a minor infringement.

In this judgment, the National Appellate Court established a novel interpretation in relation to that penalty regime, concerning the calculation method for the penalty in cases where the taxpayer, in order to avoid the late-filing surcharge, makes the payment on the tax return for a later period (without specifying that it is a correction of a previous period), rather than filing the required supplementary return.

Thus, while the tax authorities had taken as the penalty base the amount of tax not paid over correctly in the relevant tax period, the Court held that the base was the amount not paid over, that is, the tax not reported initially minus the amount paid over later, plus the late-payment surcharge that would have been payable had it been correctly adjusted. In this case, the Chamber also computed, in calculating the penalty base, the late-payment interest accrued between both tax returns.

1.13 Penalty proceeding.- The absence of reasonable interpretation of the law does not allow presumption of negligence nor does the fact of having accepted the facts justify the penalty (National Appellate Court. Judgment of November 7, 2013)

In this judgment, the National Appellate Court analyzed the principles of negligence and what constitutes an offense for the purposes of the tax penalty regime.

On this occasion, the tax authorities rejected and penalized the deduction of certain expenses. The National Appellate Court held that the fact that the Law rules out negligence where there has been a reasonable interpretation of the provision does not exhaust all possible cases of absence of negligence and that, accordingly, the penalty will be unjustified if it has been imposed automatically, that is, without specifically justifying the degree of negligence of the appellant.

The Court added that the fact of the taxpayer accepting the facts (i.e., had signed the relevant assessment on an uncontested basis) is not sufficient to penalize it and even less so for the penalty not to be justified. To impose a penalty, it is not enough to refer to the notice of assessment; but rather, the tax authorities must detail the reasons for the penalty in the penalty case file. In short, it is one thing for the taxpayer to accept the assessment and recognize the tax debt and another very different thing, to agree to the penalty where the facts which deserve to be penalized are not reflected in the relevant case file.

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1.14 Information requests.- On the need for reasoning (Supreme Court. Judgment of November 28, 2013)

The Court analyzed an information request made to a banking institution through which the tax authorities attempted to find out the details of certain transactions involving significant amounts carried out with €500 bills.

The tax authorities identified, among others, the date of some cash transactions, the number of bills involved in each transaction and whether they were used to pay in or withdraw cash by date and branch and, based on that information, requested the names of those who paid or withdrew cash above a certain amount on each of the dates, the beneficiary of each payment and the party that ordered each withdrawal. The lower court had considered that this was statistical information without tax relevance, because the information request did not identify the parties suspected of breaching information or tax obligations.

The Supreme Court held as follows in its judgment:

- Firstly, it recalled that there is a legal obligation to provide information with tax relevance to the tax authorities, although that obligation is not absolute as it is subject to restrictions such as the right to privacy.

- This right to privacy is also restricted, however, and cannot be separated from the duty for all taxpayers to contribute to sustaining public expenditure through the tax system. For that reason, the tax authorities can request data relating to the economic situation of the taxpayer, who has the duty to cooperate, a duty held by those who can assist with that task, such as the banking institutions.

- Having said that, the reasoning behind those requests is essential, and the type of information requested must be itemized, there must be proportionality and justification, and the tax relevance of the information must be evidenced in all cases. The requirement for reasoning means that the decision must set out sufficient grounds for it to be seen from it that there has been a reasonable application of the law to a specific case and for the party that receives the request to be made aware of the reasons for it.

- The Court acknowledged, however, that it is a very case-sensitive matter and that at times, it has been considered that when dealing with an act which defines a positive obligation, mentioning the laws that legally substantiate the tax relevance is sufficient reasoning, since the reasoning can be inferred simply from the contents of the information requested in relation to the aim pursued.

- After entering into an analysis of the case at issue, the Supreme Court concluded that because the requested data and transactions involved a considerable amount and had economic relevance, not only because of the amount involved but because of the bills to which the information request referred (which the Court considered had obvious significance in certain transactions performed outside the law), they evidenced the tax relevance of the requested information without needing further justification.

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The Supreme Court concluded that the information request in question was sufficiently reasoned.

2. DECISIONS AND RULINGS

2.1 Corporate income tax.– Finance costs capitalized by being added to the value of inventories are not affected by the restriction on their deductibility (Directorate-General of Taxes. Ruling V3479-13, of November 29, 2013)

Article 20 of the Revised Corporate Income Tax Law establishes that net finance costs will be deductible subject to the limit of 30% of the operating income for the year.

To clarify the interpretation of that provision, the DGT issued a ruling on July 16, 2012, establishing that the finance costs to which this provision applied must relate to borrowing for the business, and expressly excluding the finance costs which, under the accounting legislation, must be added to the value of a depreciable asset, given that they are included in the entity's tax base through the depreciation of that asset, and are subject to the limits of article 11 of the Corporate Income Tax Law.

Accordingly, the DGT ruled that the same treatment should be given to the finance costs recorded under the accounting legislation as an addition to the value of inventories. Given that those costs will effectively be recognized in income for the year and, thus, in the entity's tax base through the impairment of those inventories or when the inventories are retired from assets (whether through sale or loss), they will not be subject to the restriction contained in article 20 of the Corporate Income Tax Law.

2.2 Corporate income tax.– Even if the exemption for foreign-source dividends is elected in the prepayment, the taxpayer can choose to take the double taxation tax credit in its tax return (Directorate-General of Taxes. Ruling V3385-13, of November 19, 2013)

The question raised was whether the taxpayer could elect to apply the exemption established in article 21 of the Corporate Income Tax Law to foreign-source dividends in its corporate income tax prepayments, and then elect to take the double taxation tax credit, under article 32, in its corporate income tax return.

The DGT replied that it could. The DGT considered it correct to apply the exemption in the prepayment (including 25% of the relevant dividends, under the legislation currently applicable) while in the tax return, it could elect not to apply that exemption and instead take the double taxation tax credit. In this latter case, the DGT recalled that the full amount of the dividends should have been included in the tax base for the tax period, not just 25%, as this percentage was established exclusively, on a temporary basis, to determine the portion of tax base on which the prepayment is calculated.

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2.3 Corporate income tax.– On the prohibition against deducting finance costs on intragroup acquisitions where the lender is not part of the group (Directorate-General of Taxes. Ruling V3257-13, of November 6, 2013)

The requesting company received a loan in 2011 from a third company to acquire a group company. In fiscal year 2013, the lender and the borrower became part of the same group, and asked whether the rule preventing the deduction of finance costs established in article 14.1.h) of the Corporate Income Tax Law applied.

The DGT recalled that, under that article, if the lender is a group entity within the meaning of article 42 of the Commercial Code, and the loan is used to acquire, from another group entity, shares in another company, the restriction in article 14.1.h) of the Corporate Income Tax Law could apply, unless the taxpayer evidences that there are valid economic reasons for the transaction.

In the case analyzed, when the loan was provided to acquire the shares, the lender did not belong to the borrower's group, so the DGT held that the restriction in question did not apply.

However, the DGT cautioned that regard should be had to all the circumstances involved that might be relevant for determining the main aim of the transaction, which could be the subject of an inspection in view of all of the circumstances, not just those before or during the transaction but also those occurring afterwards.

2.4 Corporate income tax.- To be able to amortize the financial goodwill on shares acquired after December 21, 2007, proof of the foreign law must be provided (Central Economic-Administrative Tribunal. Decision of November 5, 2013)

In this case, the entity had made an adjustment to the tax base for amortization of the financial goodwill on its shares in a Turkish entity acquired in 2009. The tax authorities reassessed that adjustment based on the Commission Decision of October 28, 2009, which classified as State Aid the legislation permitting the deductibility of financial goodwill and required its recovery for investments made after December 21, 2007.

The taxpayer considered that the principle of legitimate expectations was being breached by not analyzing the specific case. The Tribunal, however, considered that the principle was not breached because the case had all the factual elements contained in the Decision. In particular, the acquisition of the holding in the nonresident entity was made in 2009, after December 21, 2007, date of publication in the Official Journal of the European Union of the Decision initiating the formal investigation proceeding and limit which, as a consequence of the application of the principle of legitimate expectation, is indicated in the Decision for recovering State aid for this item.

Last, the Tribunal analyzed the possibility of applying to the present case subarticle 4 of article 1 of the Commission Decision of 12 January 2011, in the sense that the regime established in article 12.5 of the Corporate Income Tax Law could continue to be applied in relation to "*majority shareholdings held directly or indirectly in foreign companies established in China, India or in other countries where the existence of explicit legal barriers to cross-border business combinations have been or can be demonstrated*."

In this respect, the taxpayer, based on an independent expert's report, claimed that Turkish legislation contained obstacles which prevented the cross-border merger between Turkish and Spanish entities, stating that the foregoing must be deemed an explicit legal barrier justifying the application of a special regime contained in the Decision where that situation arises.

Nonetheless, the Tribunal held that the report was not sufficient to prove the foreign law and that the taxpayer should have proven the alleged prohibition contained in the Turkish legislation.

2.5 Corporate income tax.– Expenses recognized for accounting purposes after they are incurred are deductible, even if that means "refreshing" the tax losses, if those losses could have been offset in any case (Directorate-General of Taxes. Ruling V3230-13, of November 4, 2013)

According to article 19.3 of the Corporate Income Tax Law, the expenses recognized for accounting purposes in a fiscal year after that in which they are incurred will be deductible in that tax period, provided this does not result in lower taxation than would have resulted from recognizing the expense in the year it was incurred.

In this ruling, the DGT analyzed the case of an entity that recognized for accounting purposes a charge to reserves for expenses that related to and should have been recognized for accounting purposes in previous years. As tax losses were generated in those years, the fact that the expenses were not recognized for accounting purposes in those periods has allowed the tax losses to be "refreshed."

The DGT ruled that:

- The mere fact that the company generated tax losses in the fiscal years in which the expense was not recognized does not mean *per se* that there was lower taxation than would have resulted from accounting for the expense in the year it was incurred.

- That circumstance will only arise if any tax losses generated from recognizing the expense temporarily in the correct year could not have been offset in the 18-year period, and yet they had been offset as a consequence of including those expenses in the tax base of later fiscal years.

2.6 Corporate income tax.- The deduction of input VAT by reason of a reassessment requires it to be recognized for accounting purposes as a reserve, and is treated as an accounting error (Central Economic-Administrative Tribunal. Decision of October 3, 2013. R.G. 6195/2011)

After a reassessment of 2005 VAT (in which some VAT was deemed nondeductible), the taxpayer requested the correction of its corporate income tax return for that year, in order to report the reassessed VAT as a deductible expense. The tax authorities denied the correction of the tax return because the nondeductible VAT had not been recognized for

accounting purposes as required. The Regional Economic-Administrative Tribunal, taking the opposite view, upheld the taxpayer's stance on the grounds that (i) the accounting records for fiscal year 2005 could not be altered after the VAT reassessment, and that (ii) it entailed a tax adjustment, not an accounting adjustment.

Nonetheless, the DGT appealed against that Decision, contending that:

- The accounting error must be corrected according to Recognition and Measurement Standard no. 22 of the Spanish National Chart of Accounts, by recognizing the relevant expense in a reserve account in fiscal year 2008 (fiscal year in which the judgment confirming the VAT reassessment became final).

- The tax deductibility of that expense will in all cases be conditional on its recognition for accounting purposes (on the terms set forth) and on it not determining lower taxation than would have resulted from applying the timing of recognition rules, due to it being deductible in a fiscal year after that in which it was incurred.

After analyzing the accounting legislation, the TEAC concluded that it does not entail a tax adjustment but rather an accounting adjustment because, otherwise, there would be not only a breach of the principle of accounting recognition but also an incorrect valuation of the goods and services acquired that had generated the reassessed input VAT, which would prevent the financial statements from presenting a fair view of its assets, financial position and income/loss for the year. For those reasons, the TEAC confirmed the DGT's view explained above.

2.7 Nonresident income tax.- The dynamic interpretation of tax treaties does not apply to the amendment to the Commentary on article 12 of the Model Tax Convention and Spain's Observation no. 28, following which the payment for the right to distribute standardized computer programs is no longer deemed a royalty (Central Economic-Administrative Tribunal. Decision of November 5, 2013)

In this Decision, the TEAC analyzed an entity's application for a refund of amounts incorrectly paid over, in respect of the withholdings made on amounts paid after July 17, 2008, for rights to distribute copies of standardized computer applications.

This was based on the addition of a new paragraph 14.4 to the Commentary of the OECD's Committee on Fiscal Affairs on article 12 of the OECD Model Tax Convention, published on July 17, 2008, and Observation no. 28 made by Spain in that respect, which caused the payments for the right to distribute standardized computer programs to stop being considered a royalty.

In the specific case analyzed, the tax authorities allowed the refund of the withholdings made in relation to the consideration documented in two invoices issued after July 17, 2008; but it applied the standard royalty rate for copyright established in the tax treaty (10%, rather than 8%) to the consideration documented in the invoices issued before that date (albeit paid afterwards).

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In its Decision, the TEAC confirmed the tax authorities' interpretation and held, with respect to the invoices issued before July 17, 2008, that:

- We cannot talk about the "dynamic interpretation" of paragraph 28 of the Commentary on the Model Tax Convention, but rather the Spanish tax authorities' express desire to change or alter the characterization of the income (royalties before, now business income), and therefore the effects of that change can only arise from the time of the amendment.

- In order to know when the income is earned, regard must be had to Spanish domestic legislation, according to which the tax falls due when the income becomes payable.

- Therefore, Spain's Observation and the 0% withholding rate will not apply to the invoices issued before July 17, 2008, because the transaction became payable before that date, even though the payment was made after it, under the terms and conditions that were agreed.

- After the legislative amendment to the Nonresident Income Tax Law (applicable to the income paid on or after January 1, 2003), expressly establishing the definition of royalty and, in that definition, placing the rights on computer programs and copyrights in two separate categories, the reduced withholding rate applicable to copyrights will not apply to computer programs.

2.8 VAT.- On the direct effect of EU provisions (Central Economic-Administrative Tribunal. Decision of October 28, 2013).

The Tribunal analyzed whether the tax authorities could reassess the position of taxpayers by applying the direct effect of EU Directives in relation to fiscal years in which the national court's interpretation has been contrary to those Directives.

In particular, the Tribunal studied whether the tax authorities could reassess the services supplied by Property Registrars before the entry into force of Law 2/2010, on which the tax had not been charged.

Law 2/2010 adapted the legislation to what was established by the Court of Justice of the European Union in a judgment dated November 12, 2009 (case C-154/08), declaring that the services supplied to the autonomous communities by the registrars/settlement agents were subject to and not exempt from VAT, contrary to the view sustained up to that time by the Supreme Court and the DGT.

Besides explaining the effects of the Court of Justice's judgment declaring infringement by the State (declaratory effects, *res judicata* effect, and *erga omnes* enforceability), the TEAC focused on analyzing the repercussions of that judgment in relation to the parties concerned, in view of the so-called "principle of direct effect of EU Law."

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Readers are reminded here that EU provisions from which subjective rights or duties for private individuals arise, are fully enforceable and can, therefore, be invoked directly before a national court, even where that provision has been incorrectly transposed by the Member State. However, it cannot be invoked by a State that has not correctly transposed EU legislation and tries to assert it against private parties.

Based on this reasoning, the TEAC disallowed a reassessment by the tax authorities of the tax position of the private parties concerned (the registrars, in this case), and claimed the tax they did not charge at the time on the basis of the interpretation made by the national courts, even though that interpretation was contrary to the Directive.

2.9 VAT.- Evidence of the status of taxable person to apply the exemption on supplies of goods to be used in another Member State (Central Economic-Administrative Tribunal. Decision of October 17, 2013).

Article 25 of the VAT Law establishes an exemption for supplies of goods dispatched or transported to another Member State, provided that the purchaser is identified for VAT purposes in a Member State other than Spain. Under the VAT Regulations, that must be evidenced by providing a VAT identification number issued by the other Member State. The taxable persons who perform intra-Community supplies of goods must confirm, before the transaction, the validity of the purchaser's VAT identification number in the VIES system.

By applying that legislation, the courts were denying the exemption for intra-Community supplies in which the seller did not have the VAT identification number of the purchaser, or where it was not in force when the transaction was carried out. That stance has now been modified by the TEAC in this decision, on the basis of the interpretation made by the Court of Justice of the European Union in its judgment of September 27, 2012 (case C-587/09).

The TEAC held that in accordance with the tax neutrality principle governing VAT, the right to the exemption for intra-Community supplies cannot be conditional on the fulfillment of merely procedural requirements, as the above requirement goes beyond what is necessary to ensure the correct collection of the tax. Conversely, the exemption must be denied where a breach of formal requirements prevents the provision of clear proof that the substantive requirements to apply the exemption have been met. Thus, providing the VAT identification number of the purchaser serves to evidence its status as taxable person (substantive requirement for the exemption), but if the seller is able to prove this status with other forms of proof, it is not justifiable to deny the exemption, even if the VAT identification number is not valid on the date of the supply.

Accordingly, from its analysis of the facts of the case, in which the inspectors did not question the purchaser's status as trader or professional for VAT purposes and recognized that the goods were effectively transported to another Member State, the TEAC determined that the supply of goods must be exempt, even if the VAT identification number provided by the purchaser was not in force on the supply date.

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2.10 Transfer tax and capital duty.- Company liquidations in which mortgaged properties are allotted (Central Economic-Administrative Tribunal. Decision of November 14, 2013)

Following the dissolution of an entity, several properties were allotted to its shareholder, which was subrogated to the mortgage loan on them. The taxpayer filed a return for capital duty

The tax authorities then issued an assessment for transfer tax, on the ground that the subrogation to the mortgage triggered a separate taxable event from the dissolution and liquidation of the entity; specifically, an express allotment as payment for the assumption of a debt. Thus, the tax authorities applied the interpretation that had already been reiterated in the case of capital increases subscribed with the contribution of mortgaged property.

Conversely, the TEAC found that the interpretation applicable to capital increases with contribution of mortgaged property could not be transferred to the allotment of mortgaged property in dissolutions or capital reductions, because in those cases the tax base for capital duty is the gross value of the assets delivered to the shareholders; which means that the transaction cannot be taxed for transfer tax because the whole value of the property had already been made subject to capital duty.

2.11 Inheritance and gift tax.- The reduction for kinship also applies to relatives by marriage (Central Economic-Administrative Tribunal. Decision of November 14, 2013)

Following his death, the deceased's heir, a blood niece of his spouse, filed an inheritance and gift tax return in which she had applied a reduction for kinship to the third degree and for disability. The tax authorities denied the reduction for kinship because she was not a blood relative of the deceased but of his spouse and, therefore, was a collateral—not blood—relative of the deceased.

The TEAC, by applying the Supreme Court's case law, held that with respect to collateral relatives, a distinction could not be made between blood relatives or relatives by marriage, and therefore that the reduction was allowable.

2.12 Administrative proceeding.– The review of an application for a refund of amounts incorrectly paid over cannot be done through a data verification proceeding (Central Economic-Administrative Tribunal. Decision of November 28, 2013)

A nonresident entity applied for a refund of amounts withheld from the dividends obtained from resident companies. As a result, the tax authorities initiated a data verification proceeding, rejecting the refund and issuing some provisional assessments against which the entity appealed. Among other reasons, the entity contended that the data verification proceeding was not a suitable proceeding for reviewing the refund application as it involved complex legal issues that fell outside the scope of that type of proceeding.

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The TEAC considered that, indeed, the management proceeding that should have been initiated by the tax authorities was a limited review, not a data verification, as the Tribunal has in fact held many times in the past. It clarified, however, that this fact does not render the proceeding null and void but entails a defect of voidability.

2.13 Administrative proceeding.– Electronic notification is not valid if there is no record of the taxpayer's access or lack of access (Central Economic-Administrative Tribunal. Decision of November 7, 2013)

A nonresident filed an application for a refund of input VAT. The tax authorities sent electronic notifications to request certain documents which were not provided on time because the taxable person had not received the notifications.

The tax authorities denied the refund and, in the appeal phase, the taxable person produced the documents previously requested from it. The tax authorities rejected it on the ground that the documents should have been submitted when they were requested. The taxable person appealed against that denial, contending, among other matters, that the refund could not be denied on the basis of a formality and that the electronic notification could not be deemed a legally valid means.

In this scenario, the TEAC, without entering into an analysis of the merits of the case, held that notifications of requests cannot be deemed valid where they do not meet all the requirements. Specifically, in this case, there was no record in the proceeding of the taxable person's access, or lack of access, to the electronic notification.

3. LEGISLATION

3.1 Spain-Argentina tax treaty

The Convention between the Kingdom of Spain and the Argentine Republic for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital was published in the Official State Gazette on January 14, 2014.

Although the tax treaty entered into force on December 23, 2013, article 28 of the treaty gives it retroactive effect to January 1, 2013 both for taxes withheld at source on amounts paid to nonresidents, and for other taxes. Therefore, given that the term of the former treaty ended on December 31, 2012, this retroactive entry into force means that, in practice, there was no day in 2013 on which no tax treaty was applicable.

<u>The main new features adopted in the treaty are as follows</u>:

- A clause is introduced stipulating that any term or expression not defined in the tax treaty itself will, unless a different interpretation may be inferred from its context, be interpreted with the meaning ascribed to it at the time by the legislation of each State regarding the taxes covered by the treaty, and the meaning ascribed by the tax legislation will prevail over that which would result from other fields of the law of each State.

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- For cases where an individual is resident in both States, it is specified that he or she can only be resident in one of the States.

- With regard to permanent establishments, the treaty includes certain exceptions to the case where a person acts in one of the States on behalf of a company from the other contracting State.

- As for the rules on income from immovable property, the treaty includes within this category, by way of a special mention, income from agricultural or forestry operations.

  In addition, a clause is included which stipulates that where the ownership of shares or other rights directly or indirectly entitles the owner of such shares or rights to the enjoyment of immovable property, the income from the direct use, letting, or use of such right of enjoyment may be taxed in the State in which the immovable property is situated.

- Regarding interest, the treaty reduces the restriction on the tax chargeable by the State where the interest arises, such that if the recipient of the interest is the beneficial owner, the tax so charged may not exceed 12% of the gross amount of the interest instead of the 12.5% established previously.

- Computer software is included within the definition of royalties and is subject in the source State to a 10% withholding rate where the recipient of the royalties is the beneficial owner. This provision was previously contained in the protocol to the treaty rather than in the article on royalties.

- A new case of taxation at source is introduced for gains obtained by a resident of a contracting State from the alienation of shares or other ownership rights the value of which arises directly or indirectly in a proportion exceeding 50% from immovable property situated in the other contracting State. However, the tax charged is restricted to:

  - 10% of the gain where it involves a direct holding in the capital of 25% or more.

  - 15% of the gain in other cases.

  In addition, it is established that gains from the alienation of shares or other rights that directly or indirectly entitle the owner of the shares or rights to the enjoyment of immovable property situated in a contracting State, may be taxed in that State.

  Under the former wording of the treaty, gains from the alienation of any type of shares or participations in the capital or property of a company were taxed in the source State at the same percentages as those just noted above.

- As a result of this, the new treaty eliminates from the article on capital the clause that established that capital represented by shares or participations in the capital or assets of a company was taxable only in the State of which the holder was a resident. The elimination of this clause allows the ownership of shares in Argentine companies by

individuals or legal entities resident in Spain to be subject to the tax on personal assets. The elimination of this clause has surely been the main reason behind the Argentine government's decision to terminate the former treaty.

- The exchange of information provisions are amended to allow the information received to be used for other purposes if, under the law of the State requesting it, it can be used for those other purposes and the competent authorities of the State supplying the information authorizes it. In addition, the treaty restricts the cases in which the request for information from the other contracting State can be denied.

The following new features are introduced by way of the Protocol:

- With regard to the determination of the profits of the permanent establishment for the purposes of article 7.3 "business profits", the specific cases of non-deductibility of certain expenses are eliminated.

- The most favored nation clause envisaged for the following cases is eliminated:

  - Submission to the domestic rules in force on exporting for cases of exports of goods or merchandise purchased for the company.

  - Restriction on the taxation at source of interest, royalties or certain categories of such income, or of capital gains or independent personal services, including the exemption from taxation.

- As regards article 8 on shipping and air transport, the Protocol eliminates, in the case of Argentina, the exemption for gross income from the business activities consisting of international air and shipping transport carried on by Spanish enterprises, and in the case of Spain, the application of the treaty to taxes or levies, other than those of the State, which are charged on the conduct of such business activities where they are carried on by enterprises that are taxable in Argentina.

Lastly, a memorandum of understanding on the application of the treaty is included.

3.2 Notice of details of the recipient of salary income to the payor

On January 3, 2014 the Official State Gazette published the Decision of December 17, 2013, of the Tax Management Department of the State Tax Agency, amending the Decision of January 3, 2011, approving form 145 for notification of details of the recipient of salary income to the payor of the salary income or for changes in previously notified details.

The changes made to the form stem from the new provision added to the Personal Income Tax Regulations regarding the documentation to be provided in relation to reimbursement alimony or spousal and ascendant/descendant support and in relation to the transitional regime for the tax credit for investment in the principal residence.

In addition, as a new development the payor must acknowledge receipt of the filing by returning the recipient's copy of the form to the taxpayer, once section 7 "Acknowledgement of receipt" has been completed.

This decision entered into force on January 4, 2014 but will take effect for notifications of details to the payor or of changes in previously notified details, sent or which must be sent on or after January 1, 2014.

3.3 Changes in forms 595 and 525. Excise and special taxes

Order HAP/2456/2013, of December 27, 2013 was published in the Official State Gazette of December 31, 2013. The aim of the Order is as follows:

- As a result of the changes introduced by Law 16/2013, of October 29, 2013, into the Excise and Special Taxes Law, changes were made in the headings established in the tariff for the tax on oil and gas and new tax relief measures were introduced concerning the electricity tax. Consequently, the required modifications have been made to Form 595 "Special tax on coal. Return."

- In addition, following the change that Regulation (EC) No. 3199/93 has introduced in relation to the mutual recognition of procedures for the complete denaturing of alcohol for the purposes of exemption from excise tax, establishing a common procedure for the total denaturing of alcohol, this procedure is included in Order EHA/3482/2007, of November 20, 2007.

- Lastly, as a result of the entry into force of the domestic Excise Movement and Control System (EMCS), Order HAP/1229/2013, of July 1, 2013, approving the rules for completing the domestic electronic administrative document and form 525 "Domestic emergency accompanying document" relating to the protection of the movement of goods subject to excise taxes on production is adapted in relation to the minimum content of the information that must be provided.

3.4 Approval of form 165 "Information return for individual certificates issued to the shareholders or members of newly or recently created entities" and change to form 345

On December 31, 2013 the Official State Gazette published Order HAP/2455/2013, of December 27, 2013, approving form 165 "Information return for individual certificates issued to the shareholders or members of newly or recently created entities" and determining the place, manner, period and procedure for filing the form, and amending the Order of July 27, 2001, approving various forms, including a change to form 345, the annual return for "Pension plans and funds, alternative systems, welfare mutual insurance societies, insured provident plans, individual systematic savings plans, employer provident plans and care insurance policies."

Specifically:

- Readers are reminded that Law 14/2013, of September 27, 2013, to support entrepreneurs and their internationalization, established a new personal income tax incentive which took the form of a tax credit for investors (such as "business angels") who invest in newly and recently created enterprises. To be able to take the credit, the taxpayer must obtain a certificate issued by the entity whose shares have been acquired, stating the fulfillment of the requirements imposed in the tax period in which the shares were acquired. In addition, these enterprises must file an information return for the certificates issued by the entity, subject to a number of requirements.

  This order approves form 165 "Information return for individual certificates issued to the shareholders or members of newly or recently created entities" which must be filed by these entities to inform the tax authorities of the shareholders or members who have requested the certificate. The return must be filed electronically in January each year for share subscriptions in the immediately preceding year and will apply, for the first time, to the information returns to be filed for the year 2013.

- Form 345 is also amended to include a new code for reporting the premiums paid by enterprises to group care insurance policies.

- Lastly, the above-mentioned form 165 and form 270 "Annual summary of withholdings in respect of the special tax on certain lottery and betting prizes" are included among the information returns subject to Order HAP/2194/2013, of November 22, 2013, regulating the procedures and the general conditions for filing certain self-assessments and information returns.

3.5 Extension of certain state aid schemes applicable in the Canary Islands

The Decision of December 26, 2013, of the Directorate-General of Taxes, on the extension of certain state aid schemes applicable in the Canary Islands, was published in the Official State Gazette of December 30, 2013.

Readers are reminded that the internal legislation in force in the Canary Islands regulates a number of state aid schemes for which mandatory EU authorization is required. For most of the schemes, the authorization ended on December 31, 2013. By way of this decision:

- The aid scheme relating to the levy on imports and supplies of goods in the Canary Islands (AIEM), NN22/2008, amended by scheme N544/2010, is deemed extended, as worded until December 31, 2013, until June 30, 2014.

- The aid schemes for certain incentives under the Canary Islands Economic and Tax Regime (REF), N377/2006, and under the Special Canary Island Zone, N376/2006, amended by scheme N741/2007, are deemed extended, respectively, as worded until December 31, 2013, until December 31, 2014.

3.6 Regulations for the tax on fluorinated greenhouse gases and other changes introduced by various regulatory provisions

Royal Decree 1042/2013, of December 27, 2013, approving the Regulations for the tax on fluorinated greenhouse gases and amending other Regulations, which implements and completes the provisions of Law 16/2013, of October 29, 2013, which created the tax, was published in the Official State Gazette of December 30, 2013.

The Regulations govern, inter alia, the following aspects:

- Obligations to register on the territorial register, to keep a record of inventories and to file a recapitulative statement for different taxpayers.
- The obligation for the invoices issued for purchases of fluorinated gas to state the quantity and type of gas, as well as the amount of the tax, all for the purpose of verifying that the fluorinated gases that are to be destroyed, recycled or regenerated have been taxed and, therefore, can generate the right to a deduction or refund of the tax.
- Obligations for waste managers in order to verify their status.
- The procedure to be followed to apply the exemptions envisaged in the law.
- The requirements and deadlines for taxpayers and end consumers to be entitled to the deductions and refunds of the tax.

Lastly, transitional provisions are included to establish a transitional period for registering on the territorial register and for requiring the notification of the card evidencing registration; to regulate the application of the reduced rates for certain fluorinated gases; and to provide for the filing of an information return in which taxpayers state the fluorinated gases they have in storage as of January 1, 2014.

Certain changes are also made to other taxes:

- The period for electing to apply the VAT cash-basis accounting scheme is extended until March 31, 2014.
- Taxable persons applying the special VAT grouping scheme must now file the VAT return for July within the first 20 days of August.
- The Corporate Income Tax and Personal Income Tax Regulations are amended in relation to indexed government bonds and debentures, to reduce the base rate for determining when these mixed-yield government debt securities follow the tax regime for financial assets with an explicit yield, by setting it at 40% (rather than the 80% required for other assets) of the effective rate relating to the rounded weighted average price that resulted from the last auction in the preceding quarter.
- An additional provision is introduced in relation to the penalty proceeding for infringements of the rules restricting payments in cash. The provision states that where a penalty proceeding is commenced for an infringement of the restrictions on

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cash payments, certain provisions of the regulations governing the procedure for the exercise of the power to impose penalties will not apply, specifically, article 11.2 (no relationship to the body making a petition) and 13.2 (notification to the case handler for the commencement decision).

3.7 Changes to the Excise and Special Taxes Regulations

Royal Decree 1041/2013, of December 27, 2013, amending the Excise and Special Taxes Regulations, approved by Royal Decree 1165/1995, of July 7, 1995, and introducing other provisions concerning excise taxes on production and the tax on the value of electricity output was published in the Official State Gazette on December 30, 2013.

The main new changes introduced are as follows:

- The Regulations are brought into line with the new rules on reduced rates that have been laid down in relation to the various uses of natural gas and, in particular, to supplies of natural gas made to electricity and useful heat cogeneration plants.

- A mechanism is established for the provisional adjustment to be made by suppliers of natural gas in relation to the supplies made to the above-mentioned plants. This same mechanism is established in relation to the tax on coal.

- The Regulations are brought into line with the current taxation of biofuels which are taxed at identical rates to those charged on the fuel or fossil fuel with which they are mixed. In addition, the rules on the logistics tax warehouse are eliminated.

- In addition, several changes are introduced to simplify and relax certain provisions of the Regulations, thereby facilitating their application.

- Certain accounting obligations are clarified.

- As regards the management of certain exemptions and refunds of the excise tax on oil and gas, obligations are introduced in relation to the requirement to report supplies.

- Lastly, the references to legislation are corrected to update them to the current legislation.

Furthermore, Royal Decree 1715/2012, of December 28, 2012, made it mandatory to use the electronic administrative document for movements of products subject to excise taxes on production originating in or intended for the domestic territory that move under suspensive arrangements, with the application of an exemption or a reduced rate. The date by which these movements must be supported in an electronic administrative document is July 1, 2013. This royal decree extends the deadline to December 31, 2013.

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Lastly, in relation to the tax on the value of electricity output, a reporting obligation is established for public or private individuals or legal entities, as well as for the entities referred to in article 35.4 of the General Taxation Law that satisfy amounts to the taxpayers of the tax on the value of electricity output in relation to the production of, and introduction into the electricity system, of electricity, measured in power plant busbars.

3.8 Savings banks and banking foundations

Law 26/2013, of December 27, 2013, on savings banks and banking foundations, was published in the Official State Gazette of December 28, 2013.

This law is a consequence of the Memorandum of Understanding on financial-sector policy conditionality signed by Spain on July 20, 2012, under which Spain agreed to adopt legislation strengthening the rules for the governing bodies of former savings banks and the commercial banks controlled by them.

The new features introduced by this law were summarized in our Corporate/Tax Newsletter 2-2013, which can be found at the following link:

http://www.garrigues.com/es/Publicaciones/Novedades/Documents/Novedades-Mercantil-Fiscal-2-2013.pdf

3.9 General State Budget Law of 2014

December 26, 2013 saw the publication in the Official State Gazette of Law 22/2013, of December 23, 2013, on the General State Budget for 2014, which, as a general rule, merely updates the aspects of the tax legislation that are traditionally amended by the Budget Law.

The new provisions introduced by this law were summarized in our Tax Commentary 3-2013, which can be found at the following link:

http://www.garrigues.com/es/Publicaciones/Novedades/Documents/Comentario-Fiscal-3-2013.pdf

3.10 Annual effective interest rate for the first calendar quarter of 2014, for the purposes of classifying certain financial assets for tax purposes

As is customary, the government has published (in the Decision of December 26, 2013, of the Secretary-General for the Treasury and Financial Policy), the reference rates that apply for the first calendar quarter of 2014, which are as follows:

- Financial assets with a term equal to or shorter than four years: 1.746 percent.
- Assets with a term longer than four years but equal to or shorter than seven: 2.158 percent.

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- Assets with a term of ten years: 3.278 percent.
- Assets with a term of fifteen years: 3.575 percent.
- Assets with a term of thirty years: 4.170 percent.

In all other cases, the term closest to that of the issue being made will be taken as the reference rate.