GARRIGUES

bulletin TAX

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Clarifications on obligations to report assets and rights situated abroad (form 720)

Just days before the end of the period for filing the first informational return on assets and rights situated abroad (form 720), answers to FAQs are still being published on the State Tax Agency's website and the Directorate-General of Taxes is still issuing binding rulings on the subject.

As a general observation, it can be said that for this first return, which is for FY2012, the requirements for preparing it are being relaxed. Thus, for example, despite the strict wording of the law, it has been concluded that in this return taxpayers need not include assets and rights in respect of which they are no longer the owner (or beneficial owner, or authorized person, or representative or person with powers of disposal, as the case may be) as of December 31, 2012, even if they lost that status during FY2012. For subsequent years, however, the termination of these relationships with the assets and rights must be reported except in cases of total reinvestment. The standard that has been applied is that since the relationship no longer exists, it will not serve as a comparable for the future.

In addition, they have clarified that only the assets and rights that are strictly included in the law have to be reported. Accordingly, it is not necessary to report loans (unless they have been securitized), options, pension plans or real estate if ownership has yet be acquired.

Other issues have been clarified such as that of spouses under the community property system who own assets jointly. In this case, they must report the assets even if only one of them has formal title to them: the formal owner will have to report them as the owner and the other spouse as the beneficial owner.

Some issues have not been resolved such as the obligation of non-owners (authorized persons, representatives or persons with powers of disposal) to report where the owners of the assets are not persons required to report (because they are not resident in Spain or they do not act in Spain through a permanent establishment). Based on the wording of binding ruling V1184-13, it could be interpreted that in these cases there is no obligation for any of those persons to report, in accordance with the spirit of the law, which evidences a "*clear connection between the reiterated reporting obligations and the monitoring of the fulfillment of the substantive tax obligations that are binding on the various taxable persons.*"

In this bulletin we discuss the most newsworthy rulings.

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1. JUDGMENTS

1.1 Corporate income tax.- References to related-party transactions (article 16 of the Corporate Income Tax Law) or transactions performed within a group (article 42 of the Commercial Code) are not equivalent concepts (Madrid High Court. Judgment of December 4, 2012)

Spanish tax legislation often establishes special rules for situations involving related parties, referring (i) either to their membership of the same business group (within the meaning of article 42 of the Commercial Code); (ii) or to their related-party status within the meaning of article 16 of the Corporate Income Tax Law.

In this judgment, the court recalled that the two rules are different and should be interpreted independently. In the specific case in question:

- First of all, the ability to deduct the amortization of goodwill arising on the purchase some businesses from a related entity was questioned. The court concluded that the fact the entities were related did not mean that the purchaser could not deduct the amortization of the goodwill given that the rule, for these cases, restricted the ability to deduct goodwill purchased from entities in the same group within the meaning of article 42 of the Commercial Code.

- This is not the case, however, with the ability to deduct allowances recorded to cover bad debt risk, since in this case the rule that restricts the ability to deduct these allowances refers to the related-party rules contained in article 16 of the Corporate Income Tax Law and not to whether the entity in question belongs to the same business group within the meaning of article 42 of the Commercial Code.

1.2 Nonresident income tax.- Taxation of rights in software paid to US companies (Supreme Court. Judgment of March 19, 2013)

A traditional subject of dispute with Spanish tax inspectors is the characterization of payments for software licenses under the current Spain-US tax treaty. The Spanish tax authorities have been taking the view that after the amendment of the Nonresident Income Tax Law by Law 46/2002, they could not be treated as payments for "literary works" and were, therefore, not subject to the reduced 5% withholding rate but rather to the 10% rate for "other royalties."

This debate has always been resolved in the tax authorities' favor, at both the Economic-Administrative Tribunals and the National Appellate Court. Now the Supreme Court has recently published its first judgment addressing this issue in which it has also rejected the taxpayer's arguments. According to the court:

- Article 3.2 of the current Spain-US tax treaty establishes that whenever a given term is not defined in the tax treaty, it must be interpreted according to the meaning it has in the domestic legislation.

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- After the reform of article 12.1.f) of Law 41/1998, software constitutes a separate category for the purposes of both the domestic legislation and the tax treaty.

In addition, the court affirmed that Directive 2009/24/EC does not identify or treat software as a literary work either, but rather simply affords it with equal protection, and held that article 2(b) of Directive 2003/49/EC only sets out a definition of royalties which, together with payments for literary works, includes payments for other forms of copyright such as computer software and systems.

All the above led the court, as mentioned, to hold that the standard 10% withholding rate should apply.

1.3 Value added tax.- Application of the healthcare exemption to plastic surgery and cosmetic treatments (Court of Justice of the European Union. Judgment of March 21, 2013 in case C-91/12)

The European court analyzed whether plastic surgery and cosmetic treatments were exempt for VAT purposes. The court recalled that both the concepts of "medical care" and "provision of medical care" have as their purpose the diagnosis, treatment and, insofar as possible, cure of diseases or health disorders and that, according to EU case law, medical services effected for the purpose of protecting, maintaining or restoring human health can benefit from the exemption.

In this respect, the court concluded that where operations and cosmetic treatments are carried out to treat or care for patients who, as a result of an illness, injury or a congenital physical impairment, are in need of a cosmetic operation, they may be exempt. However, where the aim is merely cosmetic, they will be subject to and not exempt from the tax.

1.4 Value added tax.- Assignment of identification number to a company without resources to carry on activity (Court of Justice of the European Union. Judgment of March 14, 2013 in case C-527/11)

In this judgment, the court analyzed whether the tax authorities were entitled to refuse to assign a VAT identification number to a company that, according to the tax authorities, did not have the material, technical and financial resources to carry on the declared economic activity. The court held as follows:

- Directive 2006/112 lists the categories of persons who must be identified by an individual number, without stipulating the conditions which may be placed on the issuing of the VAT identification number, so the member states have a certain discretion in this regard.

- However, it must be borne in mind that not only persons who already carry on an economic activity are considered to be taxable persons, but also those who plan to start such an activity and who may not be in a position to prove, at this early stage of their economic activity, that they have or are going to have the resources to carry on the activity.

It therefore follows that the tax authorities cannot refuse to assign a VAT identification number to applicants solely on the ground that they are not in a position to show that they have at their disposal the above-mentioned resources to carry on the economic activity declared at the time of submitting their application for registration as taxable persons.

- However, the judgment notes that member states have the right to take measures that are necessary to prevent the misuse of identification numbers, but these measures must not go beyond what is necessary for the correct collection of the tax and the prevention of evasion, and they must not systematically undermine the right to deduct VAT, and hence the neutrality of that tax.

  It should be borne in mind that the registration of a taxable person on the register of taxable persons subject to VAT is a formal requirement, such that a taxable person cannot be prevented from exercising his right of deduction on the ground that he had not been identified as a taxable person for VAT purposes before using the goods purchased in the context of his taxed activity. Therefore, the refusal to assign a VAT identification number cannot, in principle, have any effect on the taxable person's right to deduct input VAT if the substantive conditions giving rise to that right have been fulfilled.

  Therefore, in order to be considered proportionate to the objective of preventing evasion, a refusal to identify a taxable person by an individual number must be based on sound evidence giving objective grounds for considering that it is probable that the VAT identification number assigned to that taxable person will be used fraudulently. Such a decision must be based on an overall assessment of all the circumstances of the specific case in question.

1.5 Economic-administrative proceeding.- The non-admission by the TEAC of an appeal on grounds that it was filed late exhausts the administrative jurisdiction, so if the non-admission does not succeed in the judicial review jurisdiction, the proceedings cannot be sent back to the TEAC to rule on the merits (National Appellate Court. Judgment of January 17, 2013)

In this case, a decision by the Madrid Regional Economic-Administrative Tribunal (TEAR) was notified by way of an edict as a result of the declaration that the appellant was "unknown" after an attempt notify it at its address. The taxpayer appealed against it and the Central Economic-Administrative Tribunal (TEAC) validated the notification by edict and did not admit the appeal because it had been filed late.

The National Appellate Court considered, however, that the notification by edict was incorrect in this case because the notifying agent's declaration of "unknown" at the appellant's address was incomplete (the letter of the residence had not been provided) and the TEAR had that information (it had previously delivered notifications to that address successfully). Therefore, the National Appellate Court set aside the TEAC's decision that considered that the appeal had been filed late.

The National Appellate Court recalled that this type of notification is the exception and an alternative, only admissible where personal notification has not been possible.

The government lawyer had argued that if the National Appellate Court considered the TEAC's declaration of non-admission to be incorrect (as in fact happened), the court should send the proceedings back to the TEAC so it could rule on the merits of the case. The National Appellate Court considered that the TEAC did not have a second opportunity, because the case had already been heard at the tribunals and to grant such an opportunity would be tantamount to granting preference to the authorities, which would go against the right of due process. Accordingly, it was the National Appellate Court that reviewed the merits of the case.

2. DECISIONS AND RULINGS

2.1 Informational return on assets and rights situated abroad.- Form 720 (various rulings by the Directorate-General of Taxes)

The Directorate-General of Taxes (DGT) issued several rulings between February and April clarifying some of the doubts that had arisen in relation to form 720 (return on assets and rights situated abroad). Some of them were discussed in our bulletins for February and March. We highlight here some of the most interesting new rulings:

- On the purpose of the return: Ruling CV1184-13 highlights the clear connection between the reporting obligations of form 720 and the monitoring of fulfillment of the substantive tax obligations that are binding on the various taxable persons. This standard leads to the conclusion that, for example, ecclesiastic entities need not file form 720 because they are not subject to tax on their assets and rights abroad.

- On the taxable persons with a filing obligation:

  - The return must be filed by individuals who are personal income taxpayers in accordance with **article 10 of the Personal Income Tax Law**, as well as the members of bodies which, pursuant to their bylaws or the rules applicable to them, must fulfill their direct taxation obligations in Spain as personal income taxpayers, as in the case, in particular, of **civil servants and other agents of the European Union** who continue to be tax resident in Spain (CV1103-13). This rule also applies to the children dependent on them and under their guardianship (CV1221-13) even if the children were born abroad.

  - Taxpayers who have elected to apply the special **inbound expatriates** regime are not required to file the return (CV1069-13).

  - Taxpayers who only have an expectation of rights are not required to file either. Thus, for example, a future heir, where the owner of the assets has not died, is not required to file the form (CV1186-13). However, if as of December 31, 2012 the owner had died, the undistributed estate must be reported even if the assets have not been distributed among the heirs.

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- In the case of marriages under the community property system, where only one of the spouses appears as the account holder, the other spouse must file the form as a beneficial owner (CV1058-13).

- On the assets and rights to be reported:

  - Where an account includes both cash and marketable securities, the obligation to report should be applied independently with respect to the cash and the securities (CV1102-13).

  - The lending of own capital to third parties (loans) will only have to be reported where it is instrumented through representative securities (CV0955-13 and CV1183-13).

  - It may be inferred from the rulings that, with respect to FY2012, it is not necessary to report assets that are not owned as of December 31, 2012 (which also extends to authorized persons, representatives, etc. in the case of accounts and deposits). For example, in ruling CV1218-13 the DGT affirms that it is not necessary to report securities that have been **transferred in 2012 to a financial institution resident in Spain** even if those securities continue to be owned.

    For subsequent years, it has been established that (CV0817-13 and CV1067-13):

    - Assets that have maintained a **value of less than €50,000 for the entire year** need not be included in the return even if part of the assets were sold or no longer owned during the year.

    - Where securities are no longer owned following a sale and the proceeds are **reinvested in full** in purchasing other securities or rights, only the balances as of December 31 must be reported.

    - Once an asset has been reported in a return for a prior year, the sale or termination of the ownership must be included in the informational return **regardless of the proceeds of the sale** (that is, there is no minimum threshold in these cases).

  - **Real estate that has not been built or that has started to be built but has not been completed** need not be reported (CV1219-13).

- On the value of the assets and rights to be reported:

  - The value of the assets that must be reported is their total value, regardless of whether or not they belong to various parties (case of co-ownership), but, in this case, indicating the percentage share that is owned (CV0689-13). Accordingly, the €50,000 threshold below which there is no obligation to report will be calculated according to the total value and not the value of the percentage share that is owned.

- Accounts denominated in foreign currency will be valued at the exchange rate prevailing as of December 31 of the year, both for the balance as of that date and for the balance of the last quarter (CV0691-13).

- The value of securities representing a holding in the equity of listed foreign entities may be determined by any of the means established in articles 15 and 16 of the Wealth Tax Law. The market price as of December 31 may also be used (CV1059-13).

2.2 Corporate income tax.– Tax credit for reinvestment: the period in which reinvestment must take place is calculated by reference to when the contingent price is collected (Directorate-General of Taxes. Ruling V0410-13 of February 12, 2013)

In a transfer of shares in a company to another, the parties agreed that a portion of the price would be tied to the performance the company's EBITDA. Because of differences of opinion over the final determination of this variable price, an arbitration proceeding was commenced which was resolved several years later in favor of the transferor, entitling it to obtain an additional amount in respect of the sale price and interest. In the year of the transfer, the seller had only recorded the price received as the sale price and, therefore, had not booked any income in respect of the amount in dispute.

A report was requested from the Spanish Accounting and Audit Institute (ICAC), which concluded that income should be booked only where it is practically certain that economic benefits or profits will flow to the company and, accordingly, the income from the contingent price arose in the year in which the Arbitration Court resolved the dispute. In the DGT's opinion, this treatment for accounting purposes is also the treatment to be applied for tax purposes and, accordingly, the time when the contingent price is collected is when the income relating to that price also arises for tax purposes.

Therefore, this income qualifies for the tax credit for the reinvestment of extraordinary income and new reinvestment period starts for the new income generated from the collection of the contingent price, consisting of the year before and the three years after collection.

2.3 Personal income tax.– The "employee" requirement for real estate activity is not met if one of the shareholders or one of their children living with them is hired (Directorate-General of Taxes. Ruling V0632-13, of February 28, 2013)

An entity wholly owned by a married couple and at which the wife was the director was considering hiring a family member of the director (the son or the husband) as an employee to carry on its property leasing business. It was asked whether this would fulfill the "employee" requirement which, together with the "premises" requirement, is laid down as a minimum condition for property leasing to be considered an economic activity for personal income tax purposes.

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In this respect, the DGT considered that to define the contract as an employment contract, the current employment legislation must be applied, because this issue fell outside the tax sphere. Nonetheless, given the tax impact, the DGT analyzed the issues raised and concluded as follows:

- As regards the hiring of the director's husband, who also has a 50% interest in the company, there can be no employment relationship, given that the employment legislation does not allow this for shareholders who own an interest of 50% or more.

- With respect to the son of the shareholder/director, pursuant to article 1.2.c) of the Self-Employed Workers' Statue and additional provision seven of the revised General Social Security Law, there cannot be an employment relationship where at least half of the capital of the company at which the worker performs his or her work is distributed among shareholders with whom the worker lives or to whom the worker is related by a spousal or kinship relationship by consanguinity, affinity or adoption, up to the second degree, rebuttable by evidence of the nonexistence of effective control of the company.

  Therefore, if the son lives with his parents who are the shareholders of the entity, the relationship would be that of an independent contractor, rather than an employment, relationship, unless the nonexistence of effective control of the company is evidenced.

2.4 VAT.- The deduction of input VAT paid on the purchase of fuel must be kept separate from the deduction of VAT associated with the vehicle (Directorate-General of Taxes. rulings V2349-12 of December 10, 2012, and V2475-12 of December 18, 2012)

As a general rule, the VAT Law allows the deduction of 50% of the input VAT paid on the purchase of vehicles, on the assumption that they are used half the time (50%) in the course of a business or professional activity. However, there is no express rule for the input VAT paid on the purchase of the fuel consumed by these vehicles.

The Court of Justice of the European Union (CJEU) has held that use of a capital good in a business or professional activity determines the application of the VAT system to the good itself and not to the goods and services used to operate or maintain it, the deduction of which will depend, in particular, on the relationship between those goods and services and the taxable transactions of the taxable person.

In light of the CJEU's case law, the DGT concluded that the right to deduct the input VAT paid on the purchase of the fuel must be kept separate from the deduction applicable to the purchase of the vehicle. Accordingly, the VAT on the fuel will be deductible if the fuel is used in the business or professional activity and to the extent that it will foreseeably be used in the course of that activity, notwithstanding any adjustments that may be needed where the degree of use initially made varies, which must be evidenced by the taxable person by any means permitted by law.

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2.5 Transfer and stamp tax.– On the new wording of article 108 of the Securities Market Law (Directorate-General of Taxes. Rulings V0307-13 of February 4, 2013, V0391-13 of February 8, 2013, and V0457-13 of February 15, 2013)

Article 108.2 of the Securities Market Law was amended by Law 7/2012 with effect from October 31, 2012. According to its new wording, certain transfers of securities will be taxed as if they were a transfer of real estate if by transferring the securities the taxpayer has tried to avoid paying the taxes that would have been levied on the transfer of the real estate.

For these purposes, the law establishes a presumption that there is an intention to avoid these taxes (rebuttable by evidence to the contrary) in certain specific cases:

- Where control is obtained over an entity if at least 50% of its assets consist of real estate located in Spain that is not used in economic activities.

- Where control is obtained over an entity if its assets include securities that enable it to exert control over another entity and at least 50% of this entity's assets consist of real estate in Spain that is not used in economic activities.

- Where securities are transferred which have been received in exchange for contributions of real estate made in forming companies or in increasing their capital stock, if the real estate is not used in business or professional activities and less than three years have elapsed between the date of contribution and that of transfer.

For the DGT there are three requirements for a transfer of securities to be subject to the special rule:

- First of all, it must be a transfer of securities performed on the secondary market, which excludes the acquisition of newly issued securities.

- Second, it must involve securities not admitted to trading on an official secondary market, which excludes the transfer of marketable securities.

- Third, there must be an *animus defraudandi*, specifically an aim or intention to evade payment of the taxes that would have been levied on the transfer of the real estate, which is presumed to exist if any of the above-mentioned scenarios are present.

  For the special rule to apply, the tax authorities must provide sufficient evidence that there has been an intention to evade tax, but where any of the above scenarios are present, the burden of proof will be reversed. In these cases, the tax authorities handling the case will only have to prove the existence of the objective requirements for the transaction not to qualify for the exemption.

2.6 Transfer and stamp tax.- Taxation of the authorization to install wind farms to be used to generate electricity (Central Economic-Administrative Tribunal. Decision of February 14, 2013)

The tax inspectors issued a transfer and stamp tax assessment as a result of the authorization granted to an entity to generate electricity using a wind farm, on the ground that the authorization was akin to a concession.

In this decision, the TEAC analyzed in detail the differences between the definitions of concession and authorization, highlighting the following:

- A concession entails the existence of an activity that has been declared as a "public service," whereas the reason for an authorization arises from a broader concept such as the effect of the "public interest" on the activity, which is what justifies the administrative involvement.

- A concession always implies the existence of an "ex novo" right for the particular concession granted by the authorities, whereas an authorization implies a right arising from the free-enterprise economy that originally corresponds to any individual, but for different reasons the authorities restrict free access to that activity, and the restriction is removed through authorization or a license.

- Another distinguishing test lies in the existence of authority or powers of an administrative nature which generally exist in a concession but are not usually present in activities subject to authorization.

- Another sign differentiating them is the existence of a concession term, whereas this does not usually exist in activities subject to authorization.

- Lastly, a distinguishing test that has special relevance in the tax sphere is the consideration element in concessions: generally, a periodic amount or charge or even bearing the cost of the construction of the facilities or infrastructure necessary to provide the service.

The court highlighted that, despite the academic differences between concessions and authorizations, the dividing line between the two concepts is not so clear-cut in some cases and, for that reason, the tax legislation itself provides that certain authorizations are subject to tax as concessions.

That said, the TEAC noted that the electricity industry is a service of general economic interest that must be treated as an essential service, which justifies the involvement of a public authority both when the authorization is granted and for the entire management of the service.

However, there is a characteristic that is essential for the tax concept of a concession (or of an authorization subject to tax) which is the existence of a shift of assets from the authorities to an individual; even more so for transfer and stamp tax purposes, which, to become chargeable, requires the existence of a transfer of assets or rights. Another highly indicative characteristic is if there is a payment from the individual to the authorities, and that payment is precisely the means for quantifying the transfer of the right.

Neither of the circumstances (shift of assets and the consideration) was found to exist in the authorization under analysis. For that reason, the TEAC, abandoning the view it took in its decision of June 14, 2012, concluded that the existence of a good or service of pronounced general interest such as the supply of electricity did not permit in itself the conclusion that there is an original right of public ownership that is transferred or assigned to an individual. For this reason, the TEAC considered that the authorization was not subject to tax.

3. LEGISLATION

3.1 Decision approving Chart of Accounts for small and medium-sized nonprofit entities

By its decision of March 26, 2013, the ICAC approved the Chart of Accounts for small and medium-sized nonprofit entities (Official State Gazette of April 9, 2013) with the aim of providing them with a single operating framework containing all the necessary elements for recording their transactions, including those of a commercial nature or conducted for profit.

This decision brings together into single piece of legislation the standards of the National Chart of Accounts applicable to nonprofit entities and those of the National Chart of Accounts for Small and Medium-sized Enterprises, without any change to the provisions of those Charts, although with some necessary adaptations according to the legal nature of the entities to which it is addressed.

3.2 Court fees

Order HAP/490/2013, of March 27, 2013, amending Order HAP/2662/2012, of December 13, 2012, approving Form 696 (self-assessment) and Form 695 (application for refund of court fees), in order to bring them into line with the provisions of Royal Decree-Law 3/2013, was published in the Official State Gazette on March 30, 2013.

The changes introduced by this order were summarized in Litigation and Arbitration Newsletter 2-2013, which readers are invited to consult at the following link:

hhttp://www.garrigues.com/en/Publicaciones/Novedades/Documents/Novedades-Litigacion-Arbitraje-2-2013-en.pdf

3.3 Recognition and measurement bases for property, plant and equipment and investment property

As a result of the entry into force of the new National Chart of Accounts (the "PGC"), the ICAC has issued some interpretations in implementing the provisions contained in the PGC on property, plant and equipment and investment property, and has expressly ruled on the period of validity of certain issues regulated in the former 1990 PGC.

In a decision issued on March 1, 2013 (Official State Gazette of March 8, 2013), the ICAC reproduces certain standards from its previous decision of July 30, 1991 approving measurement bases for property, plant and equipment, systematizes past administrative rulings and implements the recognition and measurement bases of the PGC for property, plant and equipment and investment property.

3.4 Personal income tax and wealth tax return forms for FY2012

Order HAP/470/2013, of March 15, 2013, has approved the personal income tax and wealth tax return forms for FY2012.

The period for filing returns for both personal income tax and wealth tax will be from April 24 through July 1, 2013, where the return is filed electronically. If they are filed by any other means, the filing period will be from May 6 through July 1, 2013.

However, (i) the period for confirming the personal income tax draft return electronically or by phone started on April 2, and (ii) the period for filing returns in which the payment of both taxes is made by bank direct debit starts on April 24 and runs through June 26, 2013.

4. OTHERS

4.1 Spain-United Kingdom tax treaty

This past March 25 saw the signing of a new convention between the Kingdom of Spain and the United Kingdom of Great Britain for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, which has yet to be published in the Official State Gazette.

This convention updates the articles of the previous convention, adapting them to the needs arising from the current economic and commercial relations between the two States, as well as to the changes that have been made to the OECD Model Convention for the avoidance of double taxation.

The new convention gives an answer to some of the main problems posed by the previous convention, such as the treatment of residents not domiciled in the United Kingdom and trusts, among others.

In addition, the new convention reduces withholding taxes, establishing exclusive taxation in the State of residence for dividends from majority holdings, as well as for interest and royalties.

It also includes an arbitration clause for resolving any disputes that may arise from the application of the convention.