GARRIGUES
Commentary

Tax

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Tax Reform

Amendment of the Personal Income Tax Regulations

Royal Decree 1003/2014, of December 5, 2014, amending the Personal Income Tax Regulations, approved by Royal Decree 439/2007, of March 30, 2007, on advance payments and tax credits for large families or dependents with disabilities, was published in the Official State Gazette on December 6, 2014, and came into force on January 1, 2015.

The added amendments adapt the regulations to certain pieces of new legislation introduced by Law 26/2014, of November 27, 2014 ("**Law 26/2014"**), which among others, has amended Personal Income Tax Law 35/2006, of November 28, 2006.

The main changes are discussed below.

1. Personal income tax

1.1 Tax credits for large families or dependents with disabilities

Law 26/2014 has added, effective on January 1, 2015, to the Personal Income Tax Law, a new tax credit for large families or dependents with disabilities, which will enable taxpayers meeting the requirements of (i) carrying on an activity on a self-employed or employed basis (ii) as result of which they are registered on the relevant social security or mutual insurance system, to reduce their final tax liability by making certain deductions (subject to an upper limit of €1,200 euros -€2,400 in the case of special category large families-).

The Personal Income Tax Regulations now determine both how to quantify their amount as well as the requirements and procedure for applying to AEAT, the Spanish tax agency, for their advance payment.

1.1.1 Quantification

The tax credit can be taken by any entitled taxpayer, in proportion to the number of months in which he carries on an activity on a self-employed or employed basis as a result of which he is registered on the relevant social security or mutual insurance system. Each tax credit will be subject to a limit, equal to the social security and alternative mutual insurance contributions and payments that fall due in each tax period after the date on which the above requirements are met.

The following rules will be applied in computing the number of months:

(a) A qualifying large family and disabled status will be determined by reference to their status on the last day of each month.

(b) The requirement to be registered on the relevant social security or mutual insurance system will be construed to be met where this status occurs on every day of the month.

1.1.2 Requirements and procedure for the advance payment

The taxpayers entitled to these tax credits can apply to AEAT, the Spanish tax agency, for their advance payment in respect of every month they will be registered on the social security or mutual insurance system, after they have paid contributions for certain minimum periods depending on the employee's type of contract (full-time, part-time, and so on).

To obtain the advance payment, an application must be filed (where, how and when will be determined by the Ministry of Finance and Public Authorities) for each taxpayer entitled to a tax credit. A group application may be filed, however, for all the taxpayers entitled to the credit in respect of a same descendant or ascendant, or large family, and in this application a taxpayer meeting the relevant requirements on the filing date of the application must be appointed as the first applicant. In this latter case , the payment will be made to the person appearing as the first applicant.

In the case of a group application, the advance payment will be made monthly by bank transfer in an amount of €100 for each descendant, ascendant or large family, if applied for collectively (or €200 in the case of a special category large family). If applied for separately, the payment will be in an amount determined by dividing the applicable amount among the number of taxpayers entitled to apply the minimum in respect of the same descendant or ascendant with a disability, or among the number of ascendants or orphaned siblings of both father and mother who are part of the same large family.

The Ministry of Finance and Public Authorities can authorize payment by crossed check or by check payable to order where the circumstances so justify.

The taxpayers entitled to advance payment will have an obligation to notify the tax authority of any changes affecting that advance payment. They will also have to give notification if, due to a supervening reason or circumstance, they fail to meet any of the requirements laid down for receiving that advance payment.

Lastly, where the amount for each of the tax credits does not match the amount of its advance payment, the taxpayers must make an adjustment on their personal income tax return. If they are not required to prepare and file a return, they must pay over any excess sums received. No late-payment interest will fall due by reason of the receipt, through advance payments and for reasons not attributable to the taxpayer, of sums over and above the amounts of the tax credits.

1.1.3 Assignment of the right to the tax credit

Where two or more taxpayers are entitled to any tax credit in respect of a same descendant, ascendant or large family, the right to the tax credit may be assigned to one of them. In this case, the whole amount in respect of the tax credit will be taken by the taxpayer receiving the assigned tax credit. At the same time, any amounts that might have been received in advance will be considered as obtained by the taxpayer receiving the assigned tax credit.

The tax credit will be calculated by reference to the months in which any of the taxpayers entitled to the tax credit meet the requirements for it, and to the total social security and mutual insurance contributions and payments for all of them.

Lastly, it provides that where it has been elected to receive the tax credit in advance by filing a group application, the right to the tax credit will be considered as assigned to the first applicant.

Otherwise, the right to the tax credit will be considered as assigned to the taxpayer who will take the tax credit in his return, and that information must be provided in the returns of all the taxpayers entitled to the tax credit (unless the assignor is not required to file a return, in which case the assignment will be made by filing a specific form).

1.2 Withholdings and advance payments

This royal decree adapts the Personal Income Tax Regulations in relation to advance payments to the amendments made to the Personal Income Tax Law. The most significant adaptations are those concerning salary income.

1.2.1 Salary income

The existing system for withholdings (for payments in cash and in kind) has been maintained in which fixed rates for certain types of income exist alongside a general procedure for determining the withholding rate.

The following main amendments have been made:

(a) Minimum thresholds for withholdings (for payments in cash and in kind).

The Personal Income Tax Regulations provided minimum amounts below which no withholdings (for payments in cash or in kind) have to be made. In line with the lowering of the tax approved by Law 26/2014, these thresholds have now been raised to the following amounts:

	No. of Children and Other Descendants		
Taxpayer Status	0 - Euros	1 - Euros	2 or More - Euros
1. Single, widowed, divorced or legally separated		14,266	15,803
2. Taxpayer’s spouse does not obtain income above €1,500 per annum, excluding exempt income.	13,696	14,985	17,138
3. Other status	12,000	12,607	13,275

(b) Fixed withholding rates

After the reforms introduced in the Law, the fixed withholding rates are as follows:

	2015	From 2016
Remuneration of directors and members of boards, and of the meetings that act as such, and other members of other representative bodies	37% (1) (2)	35% (1) (2)
Remuneration for courses, conferences, colloquia, seminars or similar, or in relation to the preparation of literary, artistic or scientific works, where the right to use them is transferred	19% (1)	18% (1)
Delays	15% (1)	15% (1)
Contracts for terms of under a year (minimum rate)	2%	2%
Special employment relationships for dependent work (except for the remuneration obtained by inmates in penitentiary institutions or remuneration under relationships affecting people with disabilities)	15%	15%

(1) These rates will be divided by two in the case of income obtained in Ceuta and Melilla which benefit from the statutory tax credit specifically provided for them.

(2) Where the income is from entities with revenues below €100,000, the rate will be reduced to 19% (20% in 2015)

(c) Calculation procedure for the withholding rate

The general calculation procedure for the withholding rate is maintained on similar terms to that existing to date, but with several important changes which we will explain. To make these changes easier to follow, we have summarized that procedure below.

This procedure requires the following to be determined:

(i) the calculation base for the withholding rate;

(ii) the personal and family allowance, to calculate the withholding rate;

(iii) the withholding liability;

(iv) the withholding rate.

(v) the amount of the withholding.

The method for calculating the withholding base is similar to that used to date, namely, by reducing total income by certain items, such as, basically, reductions for multiyear income and social security contributions or the reduction in respect of salary income.

A new addition that must be taken into account is the statutory tax credit for "other expenses" (restricted to €2,000 per annum generally). This reduction will not apply 2015, however, for taxpayers who are entitled in that year to the reduction for geographic mobility[1]. In these cases, the reduction for salary income will apply(restricted from 2015, by the law, to taxpayers with net salary income below €14,450, subject to certain special provisions).

Additionally, the following reductions provided only in the personal income tax regulations will continue to apply:

- For taxpayers receiving pensions and retired public employee pensions under the social security system and in retired public employee categories with more than two descendants giving entitlement to the descendant allowance: €600.

- For taxpayers receiving unemployment benefit or subsidies: €1,200.

No amendments are made in relation to determining the personal and family allowances, which will be calculated as determined in the Personal Income Tax Law. It must be remembered here that to determine these allowances:

- The withholding agent does not have to take into account, with respect to the application of allowances for descendants, ascendants or disability, whether they file personal income tax returns for incomes higher than €1,800.

- Descendants are computed at 50%, unless the taxpayer is the only person entitled to take the whole of the family allowance.

After obtaining the above aggregates, the calculation of the withholding liability will be performed by applying the withholding scale separately to each of them, and the withholding liability will be obtained by subtracting the resulting amounts. If child support is paid for offspring under a court decision (and as a new rule, only where the taxpayer is not entitled to take the allowance for descendants), the scale will be applied separately to the support amounts, to the rest of the withholding base and to the personal and family allowances (these are increased by €1,980, which to date was €1,600-).

It must be remembered that where the taxpayer's income is equal to or below €22,000 per annum, the maximum limit for the withholding liability will be 43% of the difference between the income and the amount determined from the table of withholding-free allowances.

[1] Removed effective on January 1, 2015 in the Law but with transitional rules that allow it to be applied where the taxpayer was entitled to it in 2014 and he performs the same work in 2015.

The withholding scale (approved in Law 26/2014, but included also in the Personal Income Tax Regulations) is as follows:

2015				2016		
Calculation base for withholding rate - Up to euros	Withholding liability - Euros	Remaining calculation base for withholding rate - Up to euros	Applicable rate - Percentage	Withholding liability - Euros	Remaining calculation base for withholding rate - Up to euros	Applicable rate - Percentage
0.00	0.00	12,450.00	20.00	0.00	12,450.00	19.00
12,450.00	2,490.00	7,750.00	25.00	2,365.50	7,750.00	24.00
20,200.00	4,427.50	13,800.00	31.00	4,225.50	15,000.00	30.00
34,000.00	8,705.50	26,000.00	39.00	N/A	N/A	N/A
35,200.00	N/A	N/A	N/A	8,725.50	24,800.00	37.00
60,000.00	18,845.50	Thereafter	47.00	17,901.50	Thereafter	45.00

The withholding rate will be calculated by dividing the withholding liability by the total amount of income and multiplying the resulting figure by 100. The resulting rate must be expressed with two decimal points. There is no longer any need to calculate a "preliminary withholding rate".

In cases of adjustment of the withholding rate (for which the procedure is similar to the one existing to date), it is still laid down that the resulting rate cannot be higher than 45% (23% in the case of income in Ceuta and Melilla benefitting from the tax credit for this type of income). However, for 2015, the maximum limit will be 47%/24%.

(d) Workers assigned to Spain

The withholding rate for any taxpayers who have elected the special tax regime applicable to workers assigned to Spain will be 24% (before it was 24.75%). Under a new rule, where the income paid by the same payer of salary income in the calendar year exceeds €600,000, the withholding percentage applicable to the excess will be 45% (47% in 2015), in line with the statutory amendments to this regime.

1.2.2 *Income from economic activities*

Some withholding rates for income from economic activities are amended by reason of the statutory amendments in this field. The rates as they now stand (with the requirements in the Personal Income Tax Regulations) are as follows:

		2014	2015	2016
Professional activities	Generally	21%	19%	18%
	If max. volume of gross income from immediately preceding year < €15,000 and is also higher than 75% of gross income and salary income	21%	15%	15%
	Start of professional activities (first period and following two)	9%	9%	9%

		2014	2015	2016
	Municipal collectors, insurance mediators using services of external auxiliaries and sales delegates for the Spanish government's lottery company Sociedad Estatal de Loterías y Apuestas del Estado	9%	9%	9%
Farming or livestock activities	Livestock activities for pig fattening and aviculture	1%	1%	1%
	Others	2%	2%	2%
Forestry activities		2%	2%	2%
Activities subject to the objective assessment method as provided in the Regulations		1%	1%	1%

1.2.3 *Income from movable capital*

(a) Long-term savings plan

Law 26/2014 has created a new instrument (a long-term savings plan, known as **"PALP"** from its initials in Spanish) for which it provides an exemption for the income (not for losses) generated by the life insurance policies, deposits and financial contracts funding the PALP, insofar as the taxpayer does not withdraw any of the resulting capital before the end of a period of five years since it was opened.

Law 26/2014 provides that if a breach occurs of the requirements relating to the maximum annual contribution (5,000 euros) or to the restriction on withdrawing funds within five years from when the PALP is opened, the institution must make a withholding or advance payment in respect of the income obtained since the plan was opened including any income that might be obtained from its termination.

In line with this withholding obligation, it is provided in the Personal Income Tax Regulations that:

- An obligation to make advance payments will exist where any of the stipulated breach scenarios occur; an obligation that will be incumbent on the credit institution or insurer with whom the PALP was arranged.

- The withholding base will be the amount of the income from movable capital obtained over the term of the plan to which the exemption was determined to apply.

(b) Life insurance contracts that triggered capital gains or losses before January 1, 1999

Transitional provision four of the Personal Income Tax Law provided the transitional rules applicable to life insurance contracts that triggered capital gains or losses before January 1, 1999. More specifically, that provision determines the application of "abatement coefficients". Since the amendment of the Personal Income Tax Law by Law 26/2014, those coefficients can be applied on an amount of up to €400,000 of deferred capital under life insurance contracts arranged before December 31, 1994.

It is specified in the Personal Income Tax Regulations that where a deferred capital sum is received which relates in full or in part to premiums paid before December 31, 1994, the rules in transitional provision four of the Personal Income Tax Law will only be taken into account where, before the tenth day of the month following that in which the withholding obligation occurs, the taxpayer notifies the withholding agent (for payments in cash or in kind), in writing or by any other means providing proof of receipt, of the total amount in respect of deferred capital sums giving a theoretical right to apply the coefficients, received between January 1, 2015 and the date of recognition of each deferred capital sum.

If the notification is made after the withholding obligation occurs, the entity will pay to the taxpayer any excess sums withheld.

However, where the withholding obligations occurs in the first quarter of 2015, the notification mentioned in the above paragraphs may be made until April 10, 2015.

(c) Withholding rates: the withholding rate will be 20% in 2015 and 19% in and after 2016.

1.2.4 Capital gains

(a) Transfer or redemption of shares or units in collective investment schemes.

To have the withholding agent take into account the abatement coefficients applicable to the gains obtained on any shares or units in collective investment schemes which were acquired before December 31, 1994, the taxpayer will have to notify the withholding agent (for payments in cash and in kind) of the transfer value before the tenth day of the month following that in which the withholding obligation occurs.

If the notification is made after the occurrence of the withholding obligation, that entity will pay to the taxpayer any excess sums withheld.

If, however, the withholding obligation occurs in the first quarter of 2015, the notification mentioned in the above paragraphs may be made until April 10, 2015.

2. Prepayments

The rules on prepayments have been kept on similar terms to those in force to date. This means, briefly, that any taxpayers carrying on economic activities will have to make prepayments in accordance with the following rules:

(a) In the case of activities subject to the direct assessment method, the taxpayer will have to pay over in each prepayment 20% of the net income for the period, less any prepayments made earlier in the same year.

(b) In the case of the objective assessment method, 4% of the net income resulting from applying that assessment method by reference to the base data for the first day of the year to which the payment relates (3% if there is only one salaried person and 2% if there are no salaried personnel).

The percentage will be 2% of sales or revenues in the quarter where no base data can be determined.

(c) In the case of farming, livestock, forestry or fishing activities, 2% of the revenues for the quarter, not including items of indemnification or subsidies.

(d) The above percentages are divided by two for activities giving a right to the tax credit for income obtained in Ceuta and Melilla.

(e) The payments determined under the rules explained above may benefit from certain reductions (basically, for the withholdings (for payments in cash or in kind) paid in the period, according to various rules, or specific reductions –subject to certain requirements– if sums have been put towards the taxpayer's principal residence using borrowed funds).

A new rule has been added providing that where the net income for the previous fiscal year is €12,000 or below, the payment to make will be reduced by the amount determined in the following chart:

Amount of net income for the previous year (Euros)	Amount of the reduction (Euros)
<= 9,000	100
9,000.01-10,000	75
10,000.01-11,000	50
11,000.01-12,000	25

Where this reduction is higher than the payment determined after the reductions in respect of withholdings and advance payments, the difference may be deducted from any of the following prepayments in any tax period with enough income to allow this to be done.

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