GARRIGUES
Commentary

Tax

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Tax reform bills – Main new features compared with prior preliminary bills

On June 20, 2014, the Cabinet of Ministers approved four preliminary bills which proposed a root-and-branch reform of several taxes.

Now, on August 6, 2014, the following bills have been published in the Official Parliamentary Gazette: (i) the Bill amending Personal Income Tax Law 35/2006, of November 28, 2006, the revised Nonresident Income Tax Law, approved by Legislative Royal Decree 5/2004, of March 5, 2004, and other tax provisions (**bill amending personal income tax and nonresident income tax**); (ii) the Bill for the Corporate Income Tax Law; and (iii) the Bill amending Value Added Tax Law 37/1992, of December 28, 1992; Law 20/1991, of June 7, 1991, amending the tax aspects of the Canary Islands Economic and Tax Regime; Excise and Special Taxes Law 38/1992, of December 28, 1992; and Law 16/2013, of October 29, 2013, establishing certain measures concerning environmental taxation and adopting other tax and financial measures (**bill amending VAT, the Canary Islands general indirect tax, and excise and special taxes**). However, the Bill partially amending General Taxation Law 58/2003 was not published, despite the fact that the related preliminary bill was published on June 20.

As noted, these are bills, so they are subject to the relevant passage through parliament. However, as in the case of the preliminary bills, there are already several proposed amendments that are affected by what is known as the "announcement effect", meaning that, if the reforms in question are finally approved, they will take effect in relation to taxable events that predate their entry into force.

In this Commentary, we summarize only the main differences between the preliminary bills (summarized in our *Tax Commentary – Preliminary bills for the reform of several taxes*) and the bills now published.

1. Personal income Tax

The main new features included in the bill compared with the preliminary bill are the following, which, as a general rule, are set to enter into force on January 1, 2015, save for certain exceptions which we will point out in their related sections.

1.1 Tax residence

The preliminary bill amended the article that regulates the requirements for treating a taxpayer as tax resident in Spain, in order to establish that when determining the period of the taxpayer's stay in Spain of 183 days in the calendar year, temporary stays in Spain that result from obligations acquired under cultural or humanitarian cooperation agreements, for no consideration, with the Spanish public authorities should not be computed.

However, the bill has not introduced this amendment.

1.2 Salary income. Severance pay

(i) The restriction introduced in the preliminary bill regarding the exemption for severance pay (in the amount established as mandatory in the Workers' Statute, in its implementing regulations or, as the case may be, in the legislation regulating the enforcement of judgments), is increased by €2,000 for each year worked to an overall amount of €180,000.

According to the transitional regime established, this restriction will not apply to (i) severance for dismissals or terminations that take place before August 1, 2014, or to (ii) dismissals that take place after that date where they arise from an approved collective layoff procedure, or a collective dismissal in which the commencement of the consultation period was notified to the labor authority before that date.

This change would enter into force, if approved on the proposed terms, on the day following that on which the law is published in the Official State Gazette.

(ii) As was already noted in relation to the wording of the preliminary bill, the treatment of multi-year salary income is changed so that the reduction (which goes from 40% to 30%) for income that is generated over more than two years and is not periodic or recurring will only apply if the income is received in a single tax period.

However, one of the changes introduced in the bill would permit the application of this reduction to income arising from the termination of an employment relationship, ordinary or special, even if the income is collected in installments, in which case the computation of the generation period (which will be the number of years worked by the employee) must take into account the number of years of installment, on the terms established by regulations.

This income will not be taken into consideration for the purposes of the new rule introduced in the preliminary bill (and confirmed in the bill) in relation to the non-application of the reduction to income that is generated over more than two years where, within the five tax periods prior to that in which the income becomes claimable, the taxpayer has obtained other income that is generated over more than two years to which the reduction was applied.

In addition, severance for the termination of directors' and board members' contracts for services generated over more than two years will qualify for the 30% reduction where the quotient resulting from dividing the number of years of generation, computed from date to date, by the number of tax periods of installment, is greater than two, provided that the date of termination of the relationship is prior to August 1, 2014.

1.3 Benefits under employee welfare or protected asset plans in favor of disabled persons

The bill introduces a new exemption up to the annual maximum amount of three times the public multi-purpose income indicator for salary income arising from contributions to protected assets.

1.4 Attribution for tax purposes of insurance contracts that cover both retirement and death or disability contingencies

The preliminary bill included the obligation to attribute for tax purposes the portion of the premiums paid that relate to the sum at risk due to death or disability. The bill specifies that this attribution will take place provided that the amount of that portion exceeds €50 per year.

1.5 Income from immovable capital

(i) The bill maintains the 60% reduction contained in the current Personal Income Tax Law (compared with the 50% provided for in the preliminary bill), applicable to cases of leases of properties used as the principal residence, and specifies that it will only apply in cases of net income (that is, according to the bill's wording, there would be no reduction of any net loss).

(ii) However, the bill maintains the elimination of the increased 100% reduction for leases to young people under the age of 30.

1.6 Income from movable capital

1.6.1 Long-term savings plan ("PALP")

The bill specifies that the exemption applies to income (that is, not to losses) generated by amounts deposited in deposits and financial contracts included in an individual long-term savings account ("CIALP") or instrumented in a long-term individual life insurance policy ("SIALP").

The bill also indicates that the PALP will be terminated not only when any withdrawal is made but also when the contribution limit of €5,000 per year is breached.

With respect to the guarantee to the taxpayer of the receipt of at least 85% of the amounts contributed, the bill introduces the new feature that, in cases where the guarantee is less than 100%, the financial product arranged must have a maturity of at least one year.

The bill also introduces the possibility of configuring CIALPs as financial contracts within the meaning of the last paragraph of article 2.1 of Order EHA/3537/2005, of November 10, 2005, which implements article 27.4 of Securities Market Law 24/1988, of July 28, 1988, which provides that both the contribution and the settlement upon maturity will take place in all cases in cash only. These deposits and financial contracts must be arranged by the taxpayer with the same credit institution where the CIALP was opened.

The bill adds that CIALPs must be individually identified and separate from other forms of deposit.

Other new features introduced in the bill include the following:

- The contracting institutions must expressly and notably state the amount and date of the guarantee in the contract, as well as the financial conditions on which the taxpayer can draw on the resulting capital or make new contributions before the expiration of the individual life insurance policy, of the deposit or of the financial contract.

- The bill establishes that where the plan is terminated due to a breach of one of the requirements, withholdings will be made not only, as the preliminary bill indicated, on the income from movable capital obtained since the plan opened, but also on any income that may be obtained as a result of its termination.

- Lastly, the bill provides that any losses from movable capital incurred during the term of the PALP, including any that may be incurred on the termination of the PALP, will be recognized in the tax period in which the termination occurs and only insofar as the total losses exceed the sum of the income from the same plan to which the exemption would have applied.

1.6.2 *Individual savings plans*

The minimum duration of systematic individual savings plans (PIASs) is reduced from 10 to 5 years.

These involve life insurance policies in order to set up an assured annuity with the resources contributed, so that the income generated until the annuity is set up is exempt provided that certain requirements are met. One of these is the age of the first premium paid when the annuity is set up, which becomes 5 years instead of the 10 initially envisaged.

The bill permits the application of this time reduction for PIASs formalized before January 1, 2015, clarifying that the conversion of a PIAS before January 1, 2015, or of a life insurance policy formalized before January 1, 2007 and converted into a PIAS (as regulated in transitional provision fourteen of the Personal Income Tax Law) by changing the maturity thereof, for the sole purpose of bringing forward the set-up of the annuity to a date that meets the age requirement of 5 years since the payment of the first premium required by the above-mentioned provisions, will have no tax effect for the policyholder.

1.6.3 *Other changes*

(i) The preliminary bill included the taxation as income from movable capital of distributions of additional paid-in capital relating to securities not admitted to trading, up to the limit of the positive difference between the value of the equity of the shares for the last fiscal year closed before the date of distribution of the additional paid-in capital, and its acquisition cost.

In addition, the value of the equity had to be reduced by the amount of the income distributed before the date of the distribution of the additional paid-in capital originating from reserves included in such equity.

The bill specifies that the value of the equity will also be reduced by the legally restricted reserves included in such equity which have been generated after the shares were acquired.

(ii) The preliminary bill provided, in relation to deferred capital insurance contracts, that if the contract combines the contingency of survival with those of death or disability and the capital received relates to the survival contingency, the income will be determined not only by the difference between the capital received and the premiums paid, but also the portion of the premiums paid that relate to the capital at risk due to death or disability that has been used up to date will be deducted,

provided that during the entire term of the contract the capital at risk is equal to or less than 4% of the mathematical provision. The bill proposes pushing this percentage up from 4% to 5%.

1.7 Income from economic activities

The bill maintains at €600,000, as in the current law, the net revenues in the immediately preceding year for the overall activities, for the purpose of applying the simplified form of the direct assessment method (the preliminary bill provided for its reduction to €500,000).

1.8 Capital gains and losses

(i) In the text of the bill, just as in the preliminary bill, it is specified that where a legal requirement or a court decision triggers monetary compensation or assets are awarded upon the dissolution of the separate property matrimonial economic regime, there will be no capital gain or loss.

However, the preliminary bill eliminated the reference to the rule that this case could not trigger the revaluation of the assets and rights awarded whereas the bill reinstates this reference.

(ii) The preliminary bill included the taxation as income from movable capital of capital reductions aimed at returning contributions that do not originate from retained earnings relating to securities not admitted to trading, up to the limit of the positive difference between the equity of the shares for the last year-end before the reduction and their acquisition cost.

It also established that the value of the equity had to be reduced by the amount of the income distributed before the reduction and originating from reserves included in such equity.

The bill specifies that the value of the equity will also be reduced by the legally restricted reserves included in such equity that have been generated after the shares were acquired.

(iii) The bill introduces a new case of exemption applicable by taxpayers over the age of 65 for capital gains resulting from the transfer of any property included in their assets, provided that all of the proceeds from the transfer are used within six months to set up an assured annuity in their favor, on such conditions as may be determined by regulations.

The total maximum amount that may be used to set up annuities will be €240,000.

In cases where the reinvested proceeds are lower than the total proceeds received on the transfer, only the portion of the capital gain obtained that relates to the reinvested proceeds will be excluded from taxation.

If the economic rights arising from the annuity that is set up are brought forward in whole or in part, the capital gain in question will be subject to tax.

1.9 Contributions to pension plans and similar systems

The bill adds a new case of surrender to the two cases currently envisaged in the Pension Plans and Funds Law (long-term unemployment and serious disease), namely, contributions that were made over ten years earlier.

Therefore, it will be possible to draw early on contributions to pension plans, insured provident plans, corporate employee welfare plans and insurance contracts arranged with welfare mutual insurance societies that were made at least ten years earlier, as well as on the income generated by those contributions. The terms, conditions and limits on which the vested rights can be realized will be established by regulations.

Starting January 1, 2025, the vested rights existing as of December 31, 2014 may be realized with the income corresponding to them.

In the case of corporate employee welfare plans and those arranged with mutual insurance societies for workers of companies, the early realization of rights derived from premiums or contributions paid at least ten years beforehand will be possible if the commitment in question so permits and it is provided for in the relevant insurance policy or benefits regulations.

1.10 Personal and family allowances

The bill includes the possibility of applying the amount of €1,150 in respect of an allowance for ascendants (provided that the right to it is generated) in the event of the death of the ascendant.

To this end, it will be necessary, in this case and before the tax period ends, for the ascendant to have lived with the taxpayer at least half of the period elapsed between the start of the tax period and the date of death.

1.11 Tax credits

The bill improves the new tax credits for large families or persons with a disabled person under their care introduced in the preliminary bill.

Each of these tax credits has as a limit the total contributions to the social security system or mutual insurance societies accrued in each tax period.

However, the bill introduces the provision that, if the taxpayer is entitled to the tax credit for several ascendants or descendants with a disability, the limit will apply separately with respect to each one.

In addition, the bill provides for the possibility of regulations being introduced to govern the transfer of the right to take tax credits between taxpayers who are entitled to them in relation to the same descendant, ascendant or large family.

Lastly, the bill clarifies the cases that give the right to the tax credits for large families including the one included for siblings orphaned from their father and mother.

1.12 International tax transparency

(i) In relation to the new case of attribution introduced in the preliminary bill in cases where the nonresident entity does not have the relevant organization of human and material resources to carry out certain activities, the bill specifies that:

- The total income to be included is the amount of the tax base that results from applying the criteria and principles established in the Corporate Income Tax Law and in the other provisions relating to that tax for determining the tax base.

- In the case of dividends, shares in income or gains on the transfer of holdings, there will be no attribution for securities derived from the share in the capital or equity of entities that (i) confer at least 5% of the entity's capital, (ii) are held for a minimum period of one year, (iii) with the aim of managing and administering the holdings, provided there is the relevant organization of material and human resources, and (iv) the investee's main activity is not the management of movable or immovable property on the terms established in article 4.8.2.a) of Wealth Tax Law 19/1991.

  The requirement that at least 85% of the revenue of the investees from which the income is obtained must come from economic activities and the reference to the "indirect holding" in the capital, are eliminated.

(ii) If the provisions of the above paragraph do not apply, the taxpayer will only attribute gains from the sources currently envisaged (ownership of real estate not used in economic activities, share in equity of entities and transfer of own capital to third parties, financial/credit, insurance and service providing activities).

However, in relation to credit, financial and insurance activities or provisions of services performed directly or indirectly with related persons or entities resident in Spain and which give rise to tax deductible expenses for those resident persons, the bill specifies that the income will not be included if more than 50% of the revenues derived from those activities carried out by the nonresident entity come from transactions carried out with unrelated persons or entities.

(iii) The envisaged case of exclusion of the gains derived from the sources currently established in the Personal Income Tax Law, where the sum of their amounts is less than 15% of the total income obtained by the nonresident entity, will not apply to the income indicated in the preceding paragraph (credit, financial and insurance activities and provisions of services), which will be attributed in full.

(iv) The rules on attribution will not apply in the case of a collective investment undertaking, regulated by Directive 2009/65/EC of the European Parliament and of the Council, of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to certain undertakings for collective investment in transferable securities, other than those established in article 95 of the Personal Income Tax Law, formed and domiciled in a Member State of the European Union.

1.13 Special inbound expatriates regime

The bill establishes the requirement that the taxpayer must not have been resident in Spain in the ten tax periods preceding that in which he is transferred to Spain (the current wording and the preliminary bill both referred to "the preceding ten years").

1.14 Capital gains due to residence

In relation to the new rules applicable to cases of change of residence ("exit tax") proposed in the preliminary bill, the bill now introduces the following changes:

(i) It eliminates the reference to collective investment undertakings, maintaining the case of taxation for the positive differences between the market value of shares or holdings of any kind of entity and their acquisition cost.

(ii) In order to apply this new regime, among other requirements, the taxpayer had to have resided in Spain for five out of the last ten tax periods.

(iii) The bill increases to ten the number of years during which the taxpayer must have been resident within the last fifteen tax periods.

(iv) In cases in which the change of residence takes place as a consequence of a temporary relocation for work reasons to a country or territory that is not considered a tax haven, the preliminary bill included the possibility, following a request from the taxpayer, for the payment of the tax debt to be deferred by the tax authorities (within the five fiscal years following the last year in which the individual must file a personal income tax return), subject to certain rules.

The bill introduces the possibility for the taxpayer to ask the tax authorities to extend that term of five fiscal years where there are circumstances justifying a more prolonged temporary relocation for work reasons, without the extension in any case exceeding an additional five fiscal years.

If the relocation is made to another Member State of the European Union or of the European Economic Area, with which there is an effective exchange of tax information, the bill introduces the provision that if the individual acquires the status of taxpayer again, without there being any of the circumstances that give rise to the obligation to self-assess the capital gain, the provisions of this regime will be null and void.

1.15 In relation to withholding taxes

Royal Decree-law 8/2014, of July 4, 2014, approving urgent measures for growth, competitiveness and efficiency, established the reduced rate of 15% for income from professional activities, but (i) establishing that the maximum gross income from professional activities of the immediately preceding year must be below €15,000, and (ii) requiring that it represent more than 75% of the sum of the taxpayer's gross income from economic activities and work for that year.

The bill includes this reduced withholding rate on the same terms as provided for in that Royal Decree-law.

1.16 Reporting requirements

Regarding the reporting requirements added or expanded by the preliminary bill, the wording of the bill also introduces the reporting obligation in the following cases for:

(i) Financial institutions, with respect to insured life annuities in the new case of exemption for persons over the age of 65.

(ii) Autonomous communities and the Senior Citizens and Social Services Institute, with respect to persons who fulfill the condition of large family, and to information on the degree of disability of disabled persons.

1.17 Tax reassessment in relation to foreign pensions

The possibility is established of regularizing the tax situation without incurring surcharges, interest or penalties, by filing supplementary self-assessments, for personal income taxpayers who have received foreign pensions subject to that tax and have not reported that income in the tax periods for which the voluntary filing period has ended at the date of entry into force of this provision.

The reassessment of the tax periods not statute-barred will be done in the non-extensible period of six months following its entry into force.

If the inclusion of these pensions determines that a taxpayer becomes obliged to file a personal income tax return, the reassessment will be done by filing the relevant tax return, specifying the total income obtained in that fiscal year.

Whether or not they have become final, the following will be forgiven pursuant to this provision:

(i) Surcharges, interest and penalties derived from the late filing of personal income tax returns in which the taxpayer has included foreign pensions subject to tax, assessed or imposed before the entry into force of this provision.

(ii) Tax penalties derived from assessments in which such income has been reassessed prior to the entry into force of this provision.

(iii) Surcharges of the enforcement period assessed for this item.

If the assessment of the surcharges, interest and penalties has become final, the taxpayer must request their forgiveness from the tax authorities in the maximum period of six months following the entry into force of this provision, sufficiently identifying the items assessed and the payments made.

If, in the assessment made, other income apart from the pensions has been included, the forgiveness of the surcharges, interest and penalties will be proportional to the amount of the pensions included with respect to the rest of the income being reassessed.

However, if the inclusion of the pensions determines that a taxpayer becomes obliged to file a personal income tax return, the total surcharges, interest and penalties will be forgiven.

The amounts of interest, surcharges and penalties paid over will be refunded without late-payment interest in the period of six months following the filing of the request. If that period elapses without the refund having been made, the tax authorities will pay the relevant late-payment interest.

2. Corporate income Tax

As we stated in our tax commentary on the preliminary bills, the Bill for the Corporate Income Tax Law presents a new law on the tax which amends many aspects in relation to the law currently in force, Legislative Royal Decree 4/2004 (the “TRLIS”).

The wording of the Corporate Income Tax Bill expressly establishes that the new corporate income tax legislation will take effect starting on January 1, 2015 (readers will recall that the wording of the preliminary bill erroneously stated that the date of entry into force was January 1, 2016).

The main changes in the Corporate Income Tax Bill as compared to the preliminary bill are as follows:

2.1 In relation to the tax base

2.1.1 Definition of economic activity

The bill recovers the concept of asset-holding entity, which will be that in which more than half of its assets are formed by securities or are not used in an economic activity (that is, entities whose main activity consists of managing movable or immovable property).

This definition is relevant for the purpose of applying certain special regimes and rules (i.e., exemption for the avoidance of double taxation, tax rate, international fiscal transparency, special regime for entities of a reduced size, or special regime for foreign-securities holding companies).

2.1.2 Time limit for the deduction of intra-group losses

The preliminary bill already established the impossibility of deducting the losses generated on the intra-group transfers of shares or holdings, of property, plant and equipment, investment property, intangible assets and debt securities until the period in which they are transferred to third parties unrelated to the group or the transferors and acquirers leave the group.

It is now clarified that the losses can generally be deducted when they are written off by the acquirer.

2.1.3 Deductibility of finance costs:

(i) The preliminary bill established that the nondeductibility of the return on equity would apply to all equity having such nature from a commercial standpoint (e.g. shares without voting rights or redeemable shares), regardless of its accounting treatment. Included in this category were participating loans granted by entities in the same group of companies within the meaning of article 42 of the Commercial Code.

The bill now clarifies the definition of <u>return on equity</u>, stating that it will be that relating to the securities representing the capital or equity of entities, regardless of its accounting treatment.

It also expressly states that the tax treatment derived from a holding in <u>preferred shares</u> will be that of their accounting treatment.

And, moreover, it clarifies that the restriction on the deductibility of the remuneration of <u>participating loans</u> will not apply to contracts executed before June 20, 2014.

(ii) As in the preliminary bill, the "30% rule" existing in the current legislation in connection with the deductibility of finance costs is maintained on similar terms. However, the preliminary bill required, in order for dividends received to be computed as "operating income", a minimum investment of €50 million, rather than the €6 million currently required, where the holding owned is less than 5%.

The bill reduces that amount from €50 million to €20 million.

(iii) Moreover, the new provision introduced in the preliminary bill restricting the deductibility of finance costs derived from acquisitions of holdings in other entities is relaxed where the acquired entity is then included in the tax group of the acquirer or undergoes restructuring.

For these purposes:

(a) The restriction is limited in case of merger or inclusion in a consolidated tax group to 4 years following the purchase.

(b) The bill establishes the possibility of offsetting the finance costs that are not deductible for this reason in the following years (according to the general rules on deductibility of finance costs).

(c) The bill states that this limitation on the deduction of finance costs will not apply if the debt derived from the transaction does not exceed 70% of the acquisition cost of the shares and the debt is repaid at the rate of 5 percentage points annually for 8 years (until the debt reaches 30% of the acquisition price).

(d) Lastly, it establishes that the restrictions on the deductibility specified will not apply to restructuring transactions carried out before June 20, 2014, but which affect entities already included in the same consolidated tax group prior to that date.

(iv) Other deductible expenses: directors' remuneration

The wording is clarified regarding the deductibility of the expense derived from directors' remuneration with respect to the wording of the preliminary bill, expressly stating that it will be deductible where it derives from the discharge of senior management functions or other functions derived from an employment contract with the entity.

2.1.4 Related-party transactions

The bill contains the following changes with respect to the preliminary bill:

(i) Regarding the criteria to be deemed related parties, the bill generally maintains those contained in the preliminary bill, with two exceptions:

(a) The bill eliminates the consideration of related parties in the case of remuneration paid by an entity to its directors and managers for the performance of their functions; and

(b) It eliminates the criterion establishing the relationship between two entities where one of them has decision-making power over the other, thereby eliminating the potential subjective nature of the determination of the relatedness when dealing with this type of case.

(ii) Regarding documentation obligations:

(a) The bill eliminates the cases in which specific documentation is required established in the preliminary bill for transfers of securities, businesses, real estate and intangible assets, as well as the exception to this where the amount of the consideration of the transactions for which documentation was required does not reach €250,000 in total; and

(b) In relation to the simplified regime established for related persons or entities with revenues below €45 million, the bill includes a series of cases for which it will not apply. They relate to the eliminated exceptions to the specific documentation mentioned in the preceding paragraph.

(iii) As regards the categories of transactions, the bill eliminates the requirement of being an entity of a reduced size in order for the taxpayer to be able to consider that the agreed value coincides with the market value in cases of provision of services by a professional partner to a related entity.

(iv) Lastly, regarding the secondary adjustment, pursuant to the interpretation made by the Supreme Court in its recently known judgment on this question, the bill includes in the body of the Corporate Income Tax Law what is established in subarticle 2 of article 21 bis of the Corporate Income Tax Regulations, regarding the treatment of pricing differences in the cases where relatedness is defined in terms of the shareholder/member-company relationship.

2.1.5 Exemption for the avoidance of double taxation (domestic and international)

One of the most notable of the new features of the preliminary bill for the Corporate Income Tax Law was the unification of the treatment of dividends and capital gains from holdings in companies resident and not resident in Spain.

In this way, the broad lines of the regime currently applicable to income from holdings owned abroad (exemption regime) would be extended to entities resident in Spain. In order to qualify for the exemption, the holding must be equal to at least 5% or, alternatively, must have a value exceeding €50 million, and the investee must have been charged for a tax identical or analogous to Spanish corporate income tax at a nominal rate of at least 10%.

The first significant change in the bill affects the alternative criterion of acquisition value, the amount of which is reduced from €50 million to €20 million.

The bill also adds that, if the investee obtains dividends, shares in income or gains derived from the transfer of securities representing the capital or equity of entities which exceed more than 70% of its revenues, in order to apply the exemption, the taxpayer must have an indirect holding in those entities that meets the requirements specified in relation to percentage or acquisition cost. In the case of indirect holdings in second or lower tier subsidiaries, the minimum percentage of 5% must be observed, unless those subsidiaries

meet the requirements to which article 42 of the Commercial Code refers in order to form part of the same group of companies with the direct investee and file consolidated financial statements.

Important changes have been introduced in the concept of a tax of an identical or analogous nature, and in particular:

(i) The bill clarifies that the investee must have been subject to and not exempt from the foreign tax.

(ii) It adds that the nominal rate is computed irrespective of the application of some kind of exemption, allowance, reduction or tax credit on the income distributed.

(iii) It recovers the rule that this requirement will be deemed met where the investee is resident in a country with which Spain has signed a tax treaty, which applies to it and contains an exchange of information clause.

It includes a definition of "dividend or shares in income" referring to income derived from securities representing the capital or equity of entities, irrespective of their accounting treatment, with special rules for cases of participating loans and transactions with securities of third parties.

Lastly, new cases of non-applicability or limitation of the exemption are established in cases of:

(i) Successive transfers of uniform securities.

(ii) Gains on the transfer of shares in certain asset-holding entities.

2.1.6 Offset of tax losses

(i) The preliminary bill contained a proposal to limit the offset of tax losses to 60% of the previous tax base, in all cases admitting offset up to an amount of €1 million.

Now the limit of 60% of the previous tax base will be calculated having regard to the taxpayer's tax base prior to the application of the adjustments for the new capitalization reserve.

The bill also provides that the limit on the offset of tax losses will not apply to the period in which the entity is extinguished (unless this takes place as part of a protected restructuring transaction).

(ii) On the other hand, new restrictions are introduced in order to limit the use of tax losses in cases in which companies are acquired for the sole purpose of offsetting their tax losses.

(iii) Lastly, the tax authorities' right to review tax losses is restricted with respect to the provisions of the preliminary bill; now the review must be performed within not more than 10 years after the filing deadline for the year in which the tax losses were incurred. As from that time, the taxpayer will only have to evidence their existence by furnishing the tax returns or self-assessments and accounting information for the year in which the tax losses were incurred.

2.2 Tax credits

2.2.1 International double taxation tax credit:

(i) In line with what was already introduced for tax losses and tax credits for investments ,the tax authorities' right to check unused double taxation tax credits is limited to a period of 10 years after the date following the filing deadline for the tax period in which the right to claim the tax credit arose. As from that time, the taxpayer will only have to evidence the lawfulness of the tax credits it intends to claim, as well as their amount, by furnishing the tax returns or self-assessments and the accounting information, with evidence that they were filed prior to the deadline with the Commercial Registry.

(ii) In connection with the tax credit including underlying tax (article 32 of the revised Corporate Income Tax Law), a number of changes have been introduced with a view to bringing it into line with the provisions of the article relating to the double taxation tax credit. Accordingly:

- the deadline can be calculated having regard to the period in which the holding was owned uninterruptedly by other entities which meet the requirements imposed under article 42 of the Commercial Code for companies to form part of the same group of companies, independent of residence and of the obligation to file consolidated financial statements;
- the minimum holding requirement is deemed to have been met where the acquisition cost of the holding is equal to or greater than €20 million;
- indirect holdings in second- or subsequent-tier subsidiaries must comply with the 5% minimum, unless such subsidiaries meet the requirements imposed under article 42 of the Commercial Code for companies to form part of the same group of companies with the entity owned directly, and file consolidated financial statements;
- a specific definition for "dividends or shares in profits" is introduced;
- the bill includes a number of rules aimed at preventing a taxpayer from claiming this tax credit and, at the same time, imputing the losses incurred on a transfer of the same holding.

2.2.2 Tax credits as incentives for certain activities:

(i) R&D&I tax credit: The increased tax credit of 50% stipulated in the preliminary bill for R&D expenses exceeding 10% of the net revenues, is eliminated (and replaced by an increase from €3 to €5 million in the amount of the R&D tax credit convertible into cash).

The bill also includes initial demonstration projects or pilot projects relating to animation and video games in the definition of technological innovation.

(ii) Tax credit for investments in cinematographic productions: The bill establishes, among other changes, that at least 50% of the tax credit base must relate to expenses incurred in Spain.

(iii) Tax credit for the production of live performing arts and musical shows: The bill provides for this new tax credit, and in order to claim it, a certificate must be obtained from the National Performing Arts and Music Institute and at least 50% of the income must be used over the following four years for the pursuit of other activities which qualify for the tax credit. The tax credit will be equal to 20% of the direct artistic, technical and promotional costs, less the amount of any subsidies received for the pursuit of such activities (up to a limit of €500,000 per tax period and taxpayer). The amount of the tax credit together with that of the subsidies received cannot exceed 80% of the aforesaid expenses.

2.3 Special regimes

2.3.1 Consolidated tax regime

The bill expressly excludes entities resident in the provinces of the Basque Country and Navarra, as well as and those not resident in Spain, from the configuration of the consolidated tax group (notwithstanding the fact that permanent establishments of nonresident entities which are not residents of tax havens can still be treated as parent companies of entities whose shares are linked thereto).

It also clarifies that the representative of the tax group will be its parent company, provided that such parent company is a resident of Spain.

2.3.2 International fiscal transparency

(i) The rule on the automatic attribution of "income and/or gains" provided for in the preliminary bill has undergone two significant changes:

- First, the concept is changed to "total income and/or gains", defined as the amount of the tax base resulting from the application of the methods and principles stipulated in the Law and in its implementing provisions.

- Secondly, excluded from its scope is the income and/or gains typically obtained by holding companies (dividends or shares in profits and transfers of holdings), which are governed specifically by a new subarticle 4.

  Pursuant to the new subarticle 4, such income and/or gains will not be attributed where at least 5% of an entity's capital is held and the holding is owned for at least one year, with a view to directing and managing the holding, provided that the related organization of material and human resources is present and the investee is not an asset-holding entity within the meaning of paragraph two of article 5 of the Law.

(ii) In connection with income from financial/credit, insurance and service providing activities, two significant changes have been made:

- First, the bill recovers the rule included in the Law currently in force, but eliminated in the preliminary bill, according to which income and/or gains will not be included where more than 50% of the revenues earned on such activities come from transactions carried out with non-related persons or entities within the meaning of article 18 of this Law.

- Secondly, it specifies that the exception of non-inclusion in the tax base will not apply to this income where it does not exceed 15% of the total income of the nonresident entity.

(iii) The provision of the Law currently in force, but eliminated in the preliminary bill, pursuant to which in no case will an amount exceeding the total income of the nonresident entity be attributed, is also recovered.

(iv) In order to calculate the gain on the transfer of holdings in asset-holding entities within the meaning of paragraph two of article 5 of the Law, the transfer value to be included in the calculation will be deemed equal to at least the net worth value relating to the transferred securities, as recorded on the most recent balance sheet closed, after replacing the book value of the assets with either the value they would have for wealth tax purposes or the market value, whichever is lower.

(v) Lastly, expressly excluded from the scope of this article are holdings in nonresident entities treated as collective investment undertakings regulated under Directive 2009/65/EC of the European Parliament and of the Council, of 13 July 2009, provided that they are not those provided for under article 54 of the Law and are incorporated and have their registered office in an EU Member State.

2.3.3 Foreign-security holding companies regime

As a new feature, the bill provides that exempt income obtained abroad by a Spanish holding company through a permanent establishment will qualify for the special foreign-security holding companies regime if it is distributed to nonresident shareholders of the Spanish holding company or if it forms part of the gain they obtain on the transfer of the Spanish entity.

It also provides that the new limit of €20 million, i.e., the minimum amount of the investment in the nonresident subsidiaries required to qualify for this special regime (where the minimum 5% holding is not owned), will not apply to entities already subject to the foreign-security holding companies regime in tax periods commencing prior to January 1, 2015 and complying with the quantitative limit existing until now (€6 million).

2.4 Prepayments in the 2015 period

The bill expressly stipulates that during tax periods commencing on or after January 1, 2015, the standard rate applicable to prepayments which are to be calculated by the "base method" will be as follows (considering the reduction of the standard tax rate from 30% to 28%):

(i) In general, 20% (5/7 of the standard rate, rounded down). The prepayment rate is currently 21% in this case.

(ii) For entities whose net sales figure exceeded €6 million over the 12 months preceding the date on which the 2015 tax periods commence:

(a) 20% for entities with a net revenues figure of less than €10 million (5/7 of the standard tax rate, rounded down). The prepayment rate is currently 21% in this case.

(b) 21% for entities with a net revenues figure of at least €10 million but less than €20 million (15/20 of the standard tax rate, rounded up). The prepayment rate is currently 23% in this case.

(c) 24% for entities with a net revenues figure of at least €20 million but less than €60 million (17/20 of the standard tax rate, rounded up). The prepayment rate is currently 26% in this case.

(d) 27% for entities with a net revenues figure of at least €60 million (19/20 of the standard tax rate, rounded up). The prepayment rate is currently 29% in this case.

For tax periods commencing on or after January 1, 2016, the standard prepayment rate in the "base method" will be 17% (5/7 of the standard corporate income tax rate of 25%, rounded down).

2.5 Other changes

(i) The bill maintains the concept of events of exceptional public interest (the preliminary bill foresaw the elimination of the tax incentives applicable to such events).

(ii) It refers expressly to the possibility of applying the accelerated depreciation existing until Royal Decree-Law 12/2012 came into force, with the limits, conditions and requirements originally stipulated.

(iii) It stipulates the possibility for the tax authorities to inspect and investigate events, acts, items, activities, operations, values and other circumstances determining a tax obligation, enabling them to regularize the amount relating to such items which are included in the tax base in the tax periods under inspection, even where they are the result of transactions carried out in periods which have become statute-barred.

3. Nonresident income Tax

3.1 Exemptions

(i) In the Preliminary Bill amending the Personal Income Tax Law and the Nonresident Income Tax Law a proposal was made to amend the anti-abuse clause currently in force both for distributions of dividends to parent companies resident in the EU and for payments of royalties to associated enterprises resident in the EU, in order to admit the non-application of the clause exclusively where the company (receiving the dividend or royalty) was formed and is operated on valid economic grounds and for substantive business reasons other than the management of securities or other assets.

The bill proposes the elimination of the exclusion applicable to the "*management of securities or other assets*".

(ii) An amendment is made to the definition of parent company in order to bring it into line with that found in the Corporate Income Tax Law and to avoid cases of discrimination against residents of the European Union or the European Economic Area. In particular, parent company will mean a company which paid more than €20 million to acquire the holding in its subsidiary. It also provides that the one-year holding period can be computed having regard to the period in which the holding was owned uninterruptedly

by other entities which meet the requirements imposed under article 42 of the Commercial Code for entities to form part of the same group of companies, independent of residence and the obligation to file consolidated financial statements.

3.2 Tax base

The bill eliminates the proposed rule according to which transfers of subscription rights by nonresident individuals were taxable in Spain.

4. Value added tax and Canary Islands general indirect tax

4.1 Value added tax

The bill introduces only a few changes with respect to value added tax.

In addition to purely technical corrections or adjustments, the following are the main changes made by the bill to the wording of the preliminary bill:

(i) In connection with the non-taxability of the transfer of corporate assets, it specifies that the set of assets transferred must constitute or be capable of constituting an independent economic unit at the transferor.

(ii) The new cases of reversal of liability applicable to the supply of cellular telephones, videogame consoles, digital tablets or laptop computers will apply exclusively where their amount exceeds €5,000 per customer and calendar month. The purpose of this is to avoid the application of this measure in the retail phase, which could give rise to management difficulties.

(iii) It includes access fees for professional or trade fairs or exhibitions among those able to be refunded to traders not established in the Community without requiring the existence of reciprocity.

(iv) Significant changes have been made to the regime governing groups of companies:

(a) On one hand, the wording refers to a subsequent implementation by regulations of the scope or definition of the financial, economic and organizational ties which must exist for the regime to apply.

(b) On the other, corporate enterprises which do not act as traders or professionals may be parent companies (the preliminary bill only foresaw this possibility for pure holding companies).

(c) Lastly, it establishes a transitional regime which will enable entities which had been subject to the special regime, but would be excluded due to the new requirements, to continue applying the regime in 2015.

(v) It substantially reduces the penalties stipulated for the failure to report or for the incorrect reporting by the customer of real estate transactions giving rise to the reversal of liability. The penalties will be equal to 1% of the tax payable on these transactions, with a minimum of €300 and a maximum of €10,000.

(vi) It excludes titleholders of tax warehouses relating to assets subject to excise and special taxes from the secondary liability of the titleholder of a tax warehouse other than a customs warehouse.

(vii) It postpones until January 1, 2016 the entry into force of the repeal of the system of refunds to customs agents and the restriction on the exemption for the import of assets relating to a tax warehouse other than a customs warehouse.

4.2 Canary Islands general indirect tax

The bill includes the following new features in the area of the Canary Islands general indirect tax:

(i) It includes a specification similar to that set forth under letter a) of section 4.1 above for value added tax.

(ii) The exception to the general rule on the place of supply of services, in cases in which the customer of such services is not a trader or professional, according to which the services would not be deemed supplied in the territory where the tax applies if the customer is established outside the European Union, is maintained only with respect to services consisting of the assignment and grant of copyrights, patents, licenses, factory trademarks or trade names and other intellectual or industrial property rights, as well as any other similar rights, eliminating all other related services.

(iii) It extends the scope of this tax to the new cases of reversal of liability stipulated in connection with value added tax (supplies of silver, platinum and palladium, cellular telephones and videogame consoles, laptop computers and digital tablets).

(iv) It introduces a new rule for determining the taxable amount, according to which supplies of services must include any depreciation of the assigned assets.

(v) It eliminates the changes introduced in the preliminary bill with respect to the special scheme for agriculture and livestock, the special scheme for travel agencies and the definition and contents of the special VAT grouping scheme, thus maintaining the wording currently in force.

(vi) It also stipulates a minimum of €300 and a maximum of €10,000 for penalties which could be imposed due to the failure to report by the deadline or the incorrect reporting by the customer of transactions giving rise to the reversal of liability in real estate transactions and in the execution of construction works.

(vii) It brings the provisions relating to Book II “Levy on Imports and Supplies of Goods on the Canary Islands” of Law 20/1991 into line with Law 4/2014, of June 26, 2014, amending the regulations of the levy on imports and supplies of goods on the Canary Islands.

5. Tax on Fluorinated Greenhouse Gases

The most significant amendment introduced by the bill with respect to the preliminary bill is the introduction of a special regime for the polyurethane industry, according to which the tax rate applicable to fluorinated gases used to produce polyurethane or imported or acquired in polyurethane already manufactured will be the result of multiplying the tax rate applicable according to its potential atmospheric warming by 0.10.

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