GARRIGUES
Commentary

Tax

6-2013
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TAX REFORM

New Legislation on Personal Income Tax, Nonresident Income Tax and Inheritance and Gift Tax

Law 26/2014, of November 27, 2014, 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

Law 26/2014, of November 27 2014, 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 (**personal income tax and nonresident income tax amendment law**) was published in the Official State Gazette on November 28, 2014. This Law also makes amendments to inheritance and gift tax and wealth tax and to the legislation on pension plans and funds.

The main reforms are summarized below.

1. Personal income tax

According to the preamble to the personal income tax and nonresident income tax amendment law, the aim in relation to personal income tax, is to (i) reduce the tax burden across the board, and provide a particularly significant reduction for lower-income recipients of salary income or income from economic activities and for those with greater obligations concerning dependents, (ii) to raise the tax threshold, (iii) to help generate long-term savings and (iv) to eliminate tax relief for other taxpayers.

Described below are the main measures, which are generally set to enter into force on January 1, 2015, with certain exceptions which we will highlight in the related sections:

1.1 General tax rules

1.1.1 Taxpayers: civil law partnerships

Under the new Corporate Income Tax Law 27/2014, of November 27, 2014, civil law partnerships with a commercial corporate purpose will start to be treated as corporate income taxpayers from January 1, 2016. Personal income tax legislation is amended

accordingly, to state that civil law partnerships not subject to corporate income tax will not be treated as taxpayers from that date, thus bringing the provisions on both taxes into line with each other.

At the same time a special tax regime is established for the dissolution and liquidation of civil law partnerships subject to certain requirements, as discussed in our Commentary on the new Corporate Income Tax Law.

1.1.2 Timing of recognition rules

(i) The timing of recognition of capital gains resulting from obtaining any public subsidy is postponed to the time of collection, notwithstanding the options already provided for public aid, as specified in other sections of the timing of recognition rules.

(ii) In addition, capital losses arising from past-due claims may be recognized in the tax period in which any of the following circumstances are present.

(a) where a write-off established in a court-approved refinancing agreement or an out-of-court settlement takes effect;

(b) where, while the debtor is subject to an insolvency proceeding, the arrangement establishing a write-off of the amount of the claim (in which case the loss will be computed at the amount of the reduction) takes effect or where, otherwise, the insolvency proceeding concludes without payment of the claim, unless a court orders the conclusion of the insolvency proceeding on certain grounds provided for in the Insolvency Law;

(c) where on the first anniversary since the start of a court proceeding other than an insolvency proceeding that is aimed at enforcing the claim, the claim has not been paid (this circumstance will only be taken into account where the one-year period ends on or after January 1, 2015).

Where the claim is collected after the capital loss is computed, a capital gain will be recognized as the amount collected in the tax period in which the collection takes place.

1.1.3 Definition of exempt income with progression

For the first time the Law provides a definition of “exempt income with progression”. Specifically, this will refer to income which, while not being taxed, must be taken into account to calculate the tax rate applicable to the other period income.

This income will be added to the general component or the savings component of net taxable income, as applicable according to the type of income involved, which will be used to calculate the average tax rate that must be applied to determine the gross tax charge. This average rate will then be applied to net taxable income (which will not include the exempt income with progression).

1.2 Salary income

1.2.1 Severance pay for dismissal

Because its treatment has been amended in a number of articles of the Law and the new legislation has sparked a lot of debate, we will now take a more detailed look at the overall treatment of severance pay for dismissal or termination following the reforms.

(i) The exemption

Severance pay for dismissal will continue to be exempt, as it has been until now, in the amount stipulated as mandatory by labor law (in the case of objective, individual and/or collective dismissals, the exemption will be equal to the mandatory amount for unjustified dismissal). In a new addition, however, a €180,000 ceiling has been placed on the exemption.

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

This amendment will enter into force on the date after publication of the law in the Official State Gazette (i.e., on November 29, 2014).

This ceiling will therefore now have to be taken into account for any withholding tax on cash payments and on payments in kind delivered after the law's entry into force. Conversely, in dismissals performed on or after August 1, 2014 (or approved/notified on or after that date in the case of collective dismissal procedures or collective dismissals) but before the law enters into force, the difference between the withholding tax charged (which will not have taken the quantitative limit into account) and the above ceiling will have to be paid over by the taxpayer on his 2014 personal income tax return.

(ii) Treatment as multi-year income

Non-exempt severance pay for dismissal or termination may benefit from the multi-year income regime if it was generated over a period of more than two years or is obtained on a notably multi-year basis over time. In the first case, the law adds for the first time that the number of years of service of the worker will be taken as a generation period.

As for all other multi-year salary income, the 40% reduction is pushed down to 30%.

Nonetheless, in cases of severance pay for termination of an (ordinary or special) employment relationship, this 30% reduction will be allowed to be applied even where the severance pay is received in installments (which will not be allowed for other types of multi-year salary income, as shown below). In these cases, the generation period (which, as mentioned above, will be the number of years of service of the worker) must be computed by reference to the number of years to which the installments relate, on the terms stipulated by regulations.

In the case of severance pay for termination of the independent-professional relationship of directors and board members, with a generation period longer than two years, however, the 30% reduction may only be applied where the severance pay is not received in installments, unless the relationship was terminated before August 1, 2014. In these cases, the reduction will apply if the quotient resulting from dividing the number of years in the generation period, computed from date to date, by the number of tax periods in the installment, is higher than two.

Elsewhere, income received as severance pay for dismissal or for the termination of an employment relationship will not be taken into account for the purpose of the new "non-periodic and non-recurring" rule (explained below) in connection with multi-year salary income generated over more than two years.

Lastly, it must be remembered that the above reduction is applied to an amount of up to €300,000 per year, in general, although it will be applied to a lower amount for severance pay falling between €700,000.01 and €1,000,000 (and will not be applied at all where the sums exceed this last amount). In particular, the reduction is applied as follows:

300,000 – (non-exempt severance pay – 700,000)

1.2.2 Exemptions

(i) Scholarships

Two new cases of exemption are included for (i) scholarships granted by banking foundations for nondiscretionary studies, both in Spain and abroad, at all levels and grades of the educational system, and for (ii) those granted by the same foundations for research falling under Royal Decree 63/2006, of January 27, 2006, approving the charter for research staff in training or, for research purposes for civil servants and other staff working for the public authorities and for teaching and research staff at universities.

(ii) Crew members on certain fishing vessels

A new 50% exemption is introduced for salary income obtained by crew members on fishing vessels, payable in respect of sailing fishing vessels under the Spanish flag and registered on the Community fishing fleet register (where the owner company is registered on the special register of Spanish fishing vessel companies), which fish exclusively for tuna or similar species of fish outside Community waters and at a distance further than 200 nautical miles from the baselines of the member states.

The vessel's removal from the Community fishing fleet register will place the owner of the vessel under obligation to refund any aid actually obtained in the three years before removal.

Nonetheless, the Law mentions that the actual application of this measure will be conditional on its compatibility with Community regulations.

1.2.3 Gross salary income

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

Until now, the legislation stipulated that the attribution for tax purposes of risk insurance is obligatory except in insurance contracts that cover both retirement and death or disability contingencies. As a new feature, attribution for tax purposes will be obligatory in all cases for the portion of the premiums paid that relates to the sum at risk due to death or disability, insofar as the amount of that portion exceeds €50 per year. For these purposes, "sum at risk" means the difference between the sum insured for death or disability and the mathematical provision.

(ii) Transitional regimes applicable to benefits from pension plans, welfare mutual insurance societies and insured provident plans and to benefits from group insurance policies funding pension obligations

The current Personal Income Tax Law eliminated the option of applying the 40% reduction to benefits from pension plans, welfare mutual insurance societies and insured provident plans in the form of a capital sum derived from contributions made more than two years earlier, but established a transitional regime according to which any contributions made and/or contingencies that occurred before January 1, 2007 continued to qualify for the reduction.

The reform maintains this transitional regime, but only on the following terms:

(a) For contingencies occurring on or after January 1, 2015, the previous regime may be applied if receipt of the benefit is requested in the year in which the contingency occurs or in the following two years.

(b) Earlier contingencies, i.e., those occurring before that date, are broken down into two different cases:

- contingencies that occurred between 2011 and 2014: the transitional regime will apply to benefits received until the end of the eighth year after the year in which the contingency occurred;

- contingencies that occurred in 2010 or earlier: the transitional regime will apply to benefits received through December 31, 2018.

The transitional regime applicable to group insurance policies funding pension obligations is modified in the same way.

1.2.4 Compensation in kind

(i) Treatment of the award of shares to employees

The Law finally maintains the exemption (up to a ceiling of €12,000 per year) for awards of shares by a company to its workers, but only where the offer is made on the same conditions to all the workers at the company, group or subgroups of the company, and applies the regulations to determine the terms of this case of exemption.

(ii) Right to use vehicles

The valuation of this compensation is reduced by up to 30% for vehicles considered energy efficient and the rule is extended to cases in which the compensation in kind is paid by companies that habitually engage in activities giving rise to the compensation. The specific rules in this regard will be established by regulations.

(iii) Use of a dwelling owned by the payer

It will only be allowed to value this compensation at 5% of the cadastral value (instead of the standard 10%) in the case of properties located in municipalities where cadastral values have been reviewed and have entered into force in the tax period in question or within the preceding ten tax periods.

1.2.5 Multi-year income

Multi-year income is income that is either generated over more than two years or is characterized by the regulations as income obtained on a notably multi-year basis. The reform introduces a number important new features:

(i) First, the 40% reduction is pushed down to 30%.

(ii) For income characterized as multi-year due to having been generated over more than two years, the definition of "non-periodic and non-recurring" existing until now has been refined and restricted.

In particular, it is established, generally, that the reduction will not apply if, within the five tax periods preceding the tax period in which it becomes payable, the taxpayer obtained other income generated over more than two years to which the reduction was applied (it must be remembered that, as mentioned above, severance pay for termination of an employment relationship is not taken into account in this connection).

(iii) In the specific case of stock options, until now income obtained from exercising stock options was treated as multi-year income if the options were not granted annually and were exercised more than two years after they were granted. This specific regime is eliminated (and the previous five-year rule now applies) but a transitional regime is established.

Accordingly, salary income obtained from exercising stock options granted before January 1, 2015 and exercised more than two years after they were granted, if, in addition, they were not granted annually, will qualify for the reduction even if, within the five tax periods preceding that in which they are exercised, the taxpayer obtained other income generated over more than two years to which the reduction was applied.

Nonetheless, in these cases the quantitative limits (in force on December 31, 2014 but not from January 1, 2015) on the application of the reduction will apply. In particular, the maximum amount on which the reduction can be applied is the average salary of all personal income taxpayers as a whole for the number of years over which the salary was generated. This limit will be duplicated if the shares are owned for three years after the option was exercised if, in addition, the offer of options is made on the same conditions to all workers of the company, group or subgroup of companies.

(iv) Generally, only the income attributed to a single tax period may be treated as multi-year income. The legislation hitherto in force only laid down this requirement for income obtained on a notably multi-year basis but not for income generated over more than two years and obtained in a manner that is not periodic or recurring. Following this amendment, the attribution to a single tax period is required in both cases, save in the case of severance pay for termination of the employment relationship, as explained above.

Nonetheless, a transitional regime is maintained for income other than that arising from severance pay for termination of an (ordinary or special) employment relationship, or from the independent-professional relationship of a director or manager, received in installments before January 1, 2015 and qualifying for the reduction. In these cases, the reduction will be maintained for each installment attributed on or after January 1, 2015, if the quotient resulting from dividing the number of years in the generation period, computed from date to date, by the number of tax periods in the installment, is higher than two.

It is expressly established that, where income of this type arises from commitments entered into before January 1, 2015 but is to be received in installments after that date, the replacement of the form of receipt initially agreed with receipt in a single tax period will not alter the commencement of the income's generation period.

(v) The Law keeps the annual general limit (on which to apply the reduction) at €300,000 (in addition to the specific limits for severance pay for termination of the employment relationship or independent-professional relationship explained above).

1.2.6 Deductible expenses

A new case of deductible expenses is included under the heading "other expenses" in the amount of €2,000 per year, which will be increased in certain cases:

(i) Where a change of residence takes place in cases where a job is accepted in another municipality (on the terms to be established by regulations): an additional €2,000 per year.

(ii) In the case of serving employees with disabilities: an additional €3,500, in general, or an additional €7,750 for people with disabilities who need help from third parties or have reduced mobility, or a degree of disability equal to or greater than 65%.

The limit for these expenses will be the amount of gross income after all the other deductible expenses have been subtracted.

1.2.7 Reduction for salary income

The general reduction for obtaining salary income (up to a maximum of €3,700) may now only be applied by taxpayers who obtain net salary income below €14,450 per year, insofar as the taxpayer does not obtain income, excluding exempt income, other than salary income above €6,500.

A scale is established according to which the reduction goes down if the net salary income is between €11,250 and €14,450.

The reduction for geographical mobility is eliminated, although a transitional regime is introduced enabling taxpayers who had been claiming it in 2014 and who continue performing the work in 2015 to apply the reduction in this last tax period instead of the additional amount of €2,000 provided in respect of "other expenses".

1.3 Income from immovable capital and imputed income from real estate

1.3.1 Income from immovable capital

Income from the lease of buildings used as a principal residence qualifies for certain reductions, until now equal to 60% or 100%, depending on the case.

The 60% reduction is maintained (but the increased 100% reduction for leases to people under 30 has been eliminated) and it is specified that it can only be applied in cases of net income (i.e., no reduction can be claimed on a net loss), insofar as it has been reported by the taxpayer.

In the case of multi-year income, as occurs with salary income, (i) the reduction is between 40% and 30%, and (ii) to qualify for this treatment, the income must be imputed in a single period. Lastly, (iii) the ceiling on the annual reduction base in these cases is €300,000.

A transitional regime is established, similar to the one described for salary income, in relation to income that was being received in installments before January 1, 2015.

1.3.2 Imputed income from real estate

With respect to the rules on imputed income from real estate, the rate equal to 1.1% of the cadastral value (as compared with the standard 2% rate) is restricted to properties located in municipalities where the cadastral values have been reviewed, modified or determined using a general collective valuation procedure, pursuant to cadastral legislation, and entered into force in the tax period in question or within the preceding ten tax periods.

1.4 Income from movable capital

1.4.1 Minimum exemption for dividends

The €1,500 exemption for dividends and shares in income is eliminated.

1.4.2 Reduction for multi-year income

The reduction envisaged for multi-year income is pushed down from 40% to 30%, and to be applicable, the reduction must be recognized in a single tax period. The base for the reduction is also limited to €300,000 per year.

The Law establishes the same transitional regime for the reduction for multi-year income as the one described for severance pay in relation to income that was being received in installments before January 1, 2015.

1.4.3 Long-term savings plan ("PALP")

A new instrument is created (long-term savings plan or "PALP" from its initials in Spanish) giving rise to an exemption for the income (not for losses) generated by the life insurance policies, deposits and financial contracts funding the PALP, insofar that the taxpayer does not withdraw any of the resulting capital before the end of a period of five years since it was opened.

If this requirement (or any of the requirements mentioned below) is breached, the income generated in the term of the plan must be included in the tax period in which the breach takes place and the institution must make a withholding or prepayment equal to 19% (20% in 2015) of the income obtained since the plan was opened including any income that might be obtained from its termination.

Any losses, in turn, will be recognized in the tax period in which the PALP is terminated, but only the portion of the total amount of those losses that exceed the sum of the income from the plan to which the exemption would have applied.

A PALP is a contract between the taxpayer and an insurer or credit institution that meets the following requirements.

(i) The contributed sums must be funded by one or successive long-term individual life insurance policies ("SIALPs") or by deposits and financial contracts included in a long-term individual savings account ("CIALP").

(ii) Only one PALP may be held at a time.

(iii) The PALP will be opened when the first premium is paid or the first contribution is made and will be terminated when any withdrawal is made or the contribution limit is breached, as the case may be. In the case of SIALPs (long-term individual life insurance policies), it will be considered that there are no withdrawals where, when the policy matures, the insurer allocates the amount of the benefit to another SIALP with the same institution by the same taxpayer, in which case this contribution to the new insurance policy will not be computed in the €5,000 limit mentioned below. For the purposes of the exemption, the five-year period mentioned above will start to run when the first premium is paid for the first insurance policy.

(iv) Contributions cannot exceed €5,000 annually in any fiscal year.

(v) The taxpayer may only withdraw the capital in the form of a lump sum.

(vi) The insurer or credit institution must guarantee the receipt at maturity of at least 85% of the premiums or contributions. This guarantee must be stated in the contracts expressly and conspicuously, and information must also be provided on the financial terms and conditions on the availability of the capital or the making of new contributions before maturity.

(vii) If the guarantee is lower than 100%, the purchased financial product must mature in at least one year.

(viii) The contracts must also state expressly and conspicuously that only one PALP may be held at a time, the annual quantitative limit on contributions, the inability to make partial withdrawals of the capital and the tax effects of breaching these prohibitions.

In turn, the SIALP is an individual life insurance policy that does not cover contingencies other than survival or death, and the taxpayer is the contracting party, the insured and the beneficiary except in the event of death. Its nature must be stated in the contract expressly and conspicuously. The SIALP initials are reserved for contracts concluded on or after January 1, 2015 that meet these requirements.

The CIALP is a monetary deposit contract with a credit institution (out of which one or more monetary deposits and certain financial contracts may be arranged), which provides that both the contribution and the settlement at maturity will be made in money. The deposits and financial contracts must be arranged by the taxpayer with the same institution where the CIALP is opened. The income from the deposits and financial contracts will be included in the CIALP and will not be computed in the above-mentioned €5,000 limit.

It is also required in this case for it to be identified as separate from other forms of deposit, and the CIALP initials are reserved for contracts concluded on or after January 1, 2015 that meet the above requirements; these CIALPs may only include deposits and financial contracts concluded on or after that date.

1.4.4 Individual systematic savings plans (PIASs)

PIASs (regulated in additional provision three of the Law) are life insurance policies for the purpose of setting up an insured annuity with the funds contributed, so that the income generated until the annuity is set up is exempt subject to certain requirements. One of those requirements establishes that the first premium must have been paid more than five years earlier (which used to be ten years) when the annuity is set up.

The Law also allows this reduced time period to be applied to PIASs arranged before January 1, 2015. However, it clarifies that the conversion of a PIAS arranged before January 1, 2015 into a life insurance policy (from among those regulated in transitional provision fourteen of the Personal Income Tax Law) by modifying its maturity date, solely for the purpose of bringing forward the setting up of the annuity to a date that meets the 5-year holding requirement, will have no tax effects for the policyholder.

It must be remembered that transitional provision fourteen regulates the option of converting life insurance policies arranged before January 1, 2007 in which the contracting party, the insured and the beneficiary is the taxpayer himself. That provision determines that these insurance policies may be converted into PIAs when the annuities are set up, subject to certain requirements such as, among others, that at least ten years must have elapsed since the first premium. As explained above, that period has now been changed to five years.

1.4.5 Distribution of additional paid-in capital

A distribution of additional paid-in capital may give rise to income from movable capital. As a general rule, the amount obtained will reduce the acquisition cost of the shares concerned to zero, with any excess taxed as income from movable capital.

The Law now establishes that in the case of a distribution of additional paid-in capital relating to unlisted securities, where the difference between the value of the equity represented by the shares from the latest fiscal year that ended before the date of distribution of the additional paid-in capital and its acquisition cost is positive, the amount

obtained and the normal market value of the assets and rights received will be treated as income from movable capital to the extent of that positive difference. The amount by which they exceed this limit reduces the acquisition cost of the shares.

For these purposes, shareholders' equity will be reduced by the income distributed before the distribution, originating from reserves included in that shareholders' equity, and by the restricted reserves that are included in shareholders' equity and were generated after the acquisition.

If, as a result of the above, the distribution of additional paid-in capital had determined that all or part of the amount obtained or of the normal market value of the assets or rights received was computed as income from movable capital, and the taxpayer subsequently obtains dividends or shares in income from the same entity in relation to the shares that had remained in the taxpayer's assets since the additional paid-in capital was distributed, the amount obtained from the dividends or shares in income will reduce the acquisition cost of the shares, to the extent of the previously computed income from movable capital that relates to those shares.

1.4.6 Other issues

(i) Offset for income from movable capital from instruments acquired before January 20, 2006

The Law eliminates the tax offset regime for the receipt of income from movable capital with a generation period longer than two years for taxpayers with financial instruments acquired before January 20, 2006.

(ii) Deferred capital insurance contracts

In these contracts, if the contract combines the survival contingency with death or disability contingencies and the capital received relates to the survival contingency, the income will be determined not only at 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 to date will be deducted, insofar as throughout the term of the contract the capital at risk is equal to or less than 5% of the mathematical provision.

In this respect, "capital at risk" will mean the difference between the capital insured for the above-mentioned contingencies of death or disability and the mathematical provision.

(iii) *Inter vivos* transfers for no consideration

Until now the Law established that there is no gain on transfers for no consideration of assets representing the attraction and use of third-party capital, produced by the taxpayer's death. The Law now adds that losses from movable capital on *inter vivos* transfers for no consideration of these kinds of assets will not be computed either.

(iv) The transitional regime for life insurance contracts that generate capital gains or losses before January 1, 1999

Transitional provision four of the Law had been regulating in recent years the transitional regime applicable to life insurance contracts that generate capital gains or losses before January 1, 1999.

Until now, the total net income from these insurance contracts, relating to premiums paid before December 31, 1994 and generated until January 20, 2006, was reduced by 14.28% for each year (rounded up) between the payment date of each premium and December 31, 1994. The provision also regulated how to calculate the amount by which the total net income was to be reduced.

As may be seen, this provision regulated the application of the so-called "abatement coefficients" (on which we will focus below), 14.28%, in this case (relating to transactions with "other assets" different from real estate assets and shares admitted to trading on official secondary markets).

Now, with the partial disappearance of abatement coefficients, the transitional provision is amended to contain the following:

(a) A maximum amount is established, equal to €400,000 of the deferred capital from a life insurance policy arranged before December 31, 1994, for applying abatement coefficients.

For this purpose, account will be taken not only of the amount of the deferred capital but also the amount relating to all of the life insurance policies the income from which would have been subject to the abatement coefficients, obtained from January 1, 2015 to the time of recognition of the deferred capital.

(b) Abatement coefficients will apply as follows:

- The portion of the net income that relates to each premium paid before December 31, 1994 will be determined. To ascertain the portion of the income that relates to each premium, the following calculation will be performed:

$$\frac{\text{Total net income X [(premium) X (years from premium to collection)]}}{\Sigma \text{ (each premium X years from each premium to its collection)}}$$

- For each portion of the net income that relates to each premium paid before December 31, 1994, the portion that has been generated before January 20, 2006 will be calculated. To do so, the resulting amount from the above calculation for each premium paid before December 31, 1994 will be multiplied by the following coefficient:

$$\frac{\text{Time between each premium and January 20, 2006}}{\text{Time between each premium and collection}}$$

- The taxpayer will then calculate which are the deferred capital sums from insurance policies (eligible for this transitional regime) whose net income was generated between January 1, 2015 and the time of recognition of the deferred capital.

Where the deferred capital to be reported and the sum of all those received since January 1, 2015 is lower than €400,000, the amount by which the total net income is to be reduced will be that relating to the premiums before December 31, 1994 generated before January 20, 2006 (according to the above calculations), multiplied by 14.28% and by the number of years between each premium and December 31, 1994 (such that if more than six years have elapsed by that date, the percentage will be 100%).

Where the capital in question and the other deferred capital sums received since January 1, 2015 total more than €400,000, but the sum of the latter (after removing the capital to be reported) is lower than €400,000 (that is, where it is the new capital that makes the sum exceed €400,000), then the above-mentioned reduction will be applied to each portion of the income eligible for the reduction that relates proportionally to the deferred capital which, when added to the other capital sums collected since January 1, 2015, do not total more than €400,000.

Lastly, if the sum of all the deferred capital sums collected since January 1, 2015 is already higher than €400,000, then there will be no reduction.

1.5 Income from economic activities

1.5.1 Definition of economic activity

Income from economic activity is that derived from personal work and/or capital combined, where they involve the organization by the taxpayer of the means of production and/or human resources in order to participate in the production of goods or services. The Law establishes that this type of income will include the income from extraction activities, manufacturing, commerce and provisions of services, including income from artisan, farming, forestry, cattle raising, fishing, construction and mining activities, and liberal, artistic and sports professions.

It used to be stipulated also that for these purposes, the lease of real estate would be considered to be performed as an economic activity only where its organization involved the use of at least one employee hired under an employment contract and for full time work, the taxpayer had at least one set of premises used exclusively for the activity. Now, the new amendments have eliminated the requirement to have a set of premises, and maintained the employee requirement.

Additionally, the definition of income from economic activities now expressly includes income obtained by the taxpayer originating from an entity in which he has an interest and income derived from the performance of the activities included in section two of the economic activities tax classifications (professional activities) where (i) the taxpayer is included, for this purpose, in the special social security regime for self-employed workers or (ii) a member of a welfare mutual insurance society that acts as an alternative to that special regime.

1.5.2 Determination of net income under the direct assessment method – deductible expenses

(i) Contributions to insurance contracts arranged with welfare mutual insurance societies by professionals not included in the special social security regime

The Law establishes that the contributions to welfare mutual insurance societies by the actual trader or professional are not a deductible expense (subject to the provisions of the Law regarding contributions to employee welfare programs that give the right to a reduction to net taxable income). However, it does allow the deduction of any amounts paid under insurance contracts arranged with welfare mutual insurance societies by professionals not included in the special social security regime for self-employed workers where they act as alternatives to that special regime, in the portion used to cover the contingencies covered by that regime, subject to a limit of €4,500 per year.

This quantitative limit is changed to the maximum contribution for common contingencies that will be established in each business year for that special regime.

(ii) Unsupported expenses

Under the simplified direct assessment method, the amount of deductible provisions and unsupported expenses is limited to a maximum amount of €2,000 per year (formerly, 5% of net income, excluding this expense). In any case, the determination of the amount to be deducted has been left to the Regulations, although it must be within this statutory limit.

1.5.3 Determination of net income under the objective assessment method

Effective in 2016, new requirements are established for applying the objective assessment method, both quantitative (by reducing the objective limits) and qualitative (by reducing the activities qualifying for this method).

Accordingly:

(i) Readers are reminded that to be entitled to apply this method, the first requirement is for the taxpayer not to determine the net income of any of his activities under the direct assessment method. This requirement is maintained.

(ii) There are also some quantitative requirements to be met.

Specifically, it cannot be applied by taxpayers where (i) they exceed a certain volume of gross income or (ii) of purchased goods and services (excluding acquired fixed assets) in the preceding fiscal year, or where (iii) all or part of their activities are performed outside the scope of application of personal income tax.

Until now, the computation of the quantitative limit relating to the volume of gross income only took into account the transactions that had to be recorded in the record book for sales or revenues (personal income tax) or in the record book for revenues (VAT – simplified regime) and the transactions for which invoices had to be issued and kept. And the computation of the two limits (volume of income and purchases) had to take into account both the transactions of the taxpayer and those of his spouse, descendants or ascendants and entities subject to the pass-

through tax regime in which any of them held an interest, if their economic activities were identical or similar, and there was common management with shared human and material resources.

The changes in this regard may be seen in the following table:

<table>
<tr><th></th><th></th><th>Former Law</th><th>Reform</th></tr>
<tr><td rowspan="2">Maximum volume of gross income in the immediately preceding year[1]</td><td>Set of economic activities, except farming, cattle raising and forestry[2]</td><td>450,000</td><td>150,000</td></tr>
<tr><td>Set of economic activities, except farming, cattle raising and forestry [3]</td><td>300,000</td><td>250,000</td></tr>
<tr><td>Volume of purchases of goods and services (not including acquired fixed assets) in the immediately preceding year [4]</td><td></td><td>300,000</td><td>150,000</td></tr>
</table>

(1) The volume of transactions must be grossed up in the year when an activity has been initiated.

(2) For these purposes, the law now establishes that all transactions are computed regardless of whether or not there is an obligation to issue an invoice.

This objective assessment method cannot be applied in any case where the volume of gross income in the immediately preceding year for transactions for which an invoice must be issued exceeds €75,000 in a year.

For these activities, the obligation to include the income of family members and entities under the pass-through tax regime is eliminated.

(3) Forestry activities are included in this group for the first time (and other previous limits in relation to these activities are eliminated).

In order to compute the volume of all of these activities, only the transactions that must be included in the record book for sales or revenues required in the Personal Income Tax Regulations must be computed (there is no longer any reference to the record book for revenues required in the VAT Regulations for taxable persons subject to the simplified regime or to transactions for which invoices must be issued and kept). It has been added (only for this type of activities, where before it was for all of them) that the computation must include the transactions of both the taxpayer and of his spouse, descendants and ascendants and of entities subject to the pass-through tax regime in which any of them holds an interest, if they are identical or similar and there is common management.

(4) In this case, the purchases of the spouse, descendants and ascendants and of entities subject to the pass-through tax regime on the terms specified in the previous point must also be taken into account.

(iii) Additionally, the Law establishes that starting in 2016, this method cannot be used for the activities included in divisions 3, 4 and 5 of the first section of the economic activities tax classifications that are subject in 2015 to the 1% withholding tax obligation established in the Law for business activities (other than professional, farming, cattle raising and forestry activities) that determine their net income under the objective assessment method. Moreover, the Law establishes that the Ministerial Order that will implement the objective assessment method for 2016 must reduce for the other activities the amount of the specific aggregate for their inclusion in that regime.

(iv) For taxpayers that perform auto-taxi transport activities (code 721.2 of section one of economic activities tax) and apply the objective assessment method, the Law introduces a reduction in the capital gains arising on the transfer of intangible assets by reason of permanent disability, retirement or the ceasing of operations

due to a restructuring of the industry; or where for any other reasons, the intangible assets are transferred to family members up to the second degree of kinship.

Specifically, it is established that the portion of the gain generated before January 1, 2015 will be reduced by applying percentages determined according to the time elapsed between when the intangible asset was acquired and December 31, 2014. The reductions range from 4% for assets owned for longer than a year and 100% for longer than twelve years.

1.5.4 Reductions applied to determine net income

(i) Multi-year income

A €300,000 annual ceiling has been placed on the amount of income on which the reduction for multi-year income can be applied, the percentage reduction is reduced from 40% to 30%, and it is now required for the income to be received in a single tax period.

The same transitional regime is established in relation to the reduction for multi-year income as that described for salary income, for any income received in installments before January 1, 2015.

(ii) Other reductions in net income

An amendment has been made to the regime for reductions in net income other than those for multi-year income. By this we mean the reductions that apply in the case of the direct assessment method, with respect to which the amounts and some requirements have been amended; additionally, new reductions are introduced for taxpayers that do not meet the requirements established for the above reductions.

Specifically, the requirements for the reductions in the case of the direct assessment method (incompatible with the deduction in respect of unsupported expenses under the simplified method) are as follows (some of which, as indicated, are amended):

(a) The deductible expenses associated with all the taxpayer's activities must not exceed 30% of his reported gross income.

(b) The supplies of goods or services must be made for a single unrelated individual or legal entity (on the terms of the Corporate Income Tax Law), or the taxpayer must be a dependent autonomous worker and the client on which he depends may not be a related entity on the same terms.

(c) The taxpayer must not receive salary income. It has been added that this requirement will be deemed to be fulfilled even where the taxpayer receives unemployment benefits and benefits from pension plans and the like, insofar as their amount does not exceed €4,000.

(d) At least 70% of the revenues must be subject to withholding tax.

(e) As a new provision, the taxpayer must not perform activities through pass-through entities.

(f) The taxpayer must meet some formal, disclosure, control and verification obligations to be determined by regulations.

If the taxpayer does not meet all these requirements (including that the income must be determined under the direct assessment method), he will be able to apply other reductions which have now been stipulated for the first time.

The specific reductions are as follows:

<table>
<tr><th colspan="4">Requirements</th><th>Reduction amount</th></tr>
<tr><td rowspan="5">If the established requirements are met</td><td colspan="3">General</td><td>2,000</td></tr>
<tr><td rowspan="4">Additional</td><td rowspan="2">Net income from economic activities(1)</td><td><=11,250</td><td>3,700</td></tr>
<tr><td>Between 11,250 and 14,450</td><td>3,700 – (income – 11,250) x 1.15625</td></tr>
<tr><td rowspan="2">Persons with disabilities</td><td>General</td><td>3,500</td></tr>
<tr><td>If they prove that they need help from third persons or have reduced mobility or disability >= 65%</td><td>7,750</td></tr>
<tr><td rowspan="2">If the established requirements are not met</td><td rowspan="2">Other reductions (2)</td><td rowspan="2">Non-exempt income < 12,000</td><td><=8,000</td><td>1,620</td></tr>
<tr><td>Between 8,000.01 and 12,000</td><td>1,620 – (non-exempt income – 8,000) x 0.405</td></tr>
</table>

(1) Insofar as they do not have any income, excluding exempt income other than income from economic activities, exceeding €6,500.

(2) In this case, this reduction plus the applicable reduction for salary income (explained above) may not exceed €3,700.

1.6 Capital gains and losses

1.6.1 Definition of capital gains and losses – cases in which there is no gain or loss

(i) Capital reductions

In relation to capital reductions, until now the law established that:

- Where the capital reduction gives rise to the redemption of securities or shares, those acquired first will be considered to be redeemed, and their acquisition cost will be distributed proportionally amongst the homogeneous securities remaining in the taxpayer's assets. However, where the reduction does not affect all of the taxpayer's securities equally, it will be deemed to refer to those acquired first.

- Where the purpose for the capital reduction is the repayment of contributions, its amount or the market value of the assets or rights received will reduce the acquisition cost of the securities concerned (as explained) until they are reduced to zero, and the excess will be characterized as income from movable capital unless the reduction originates from undistributed income (and in the manner established for the distribution of additional paid-in capital); in this last case, that is, if the reduction originates from undistributed income, the entire amount received will be taxed. In this regard, it is considered that the reductions must be applied first to the portion of capital that originates from undistributed income, until it is reduced to zero.

  An amendment has been added that, in these cases where the purpose for the capital reduction is the repayment of contributions, where they do not originate from undistributed income relating to unlisted securities, the amount obtained or the market value of the goods or rights received will be deemed income from movable capital, to the extent of the positive difference between the shareholders' equity represented by the shares in the latest fiscal year ended before the reduction and their acquisition cost. Any excess over and above this limit will reduce the acquisition cost of the shares.

  For these purposes, shareholders' equity will be reduced by the income distributed before the reduction which originated from reserves included in that shareholders' equity and by the amount of the legal restricted reserves included in that shareholders' equity and generated after the acquisition of the shares.

  If, as a consequence of the above, the capital reduction determines that all or some of the amount obtained or of the normal market value of the assets or rights received is computed as income from movable capital, and later, dividends or shares in income are obtained, originating from the same entity, in relation to the shares that remained in assets since the capital reduction, the amount of the dividends or shares in income will reduce their acquisition cost, to the extent of the previously computed income from movable capital relating to those shares.

(ii) Dissolution of the matrimonial economic arrangement

The Law establishes that there is no capital gain or loss on the dissolution of a separate property matrimonial economic arrangement where awards are required by law or under a court decision for reasons other than reimbursement alimony (in which case the values of the assets and rights awarded will not be revalued).

It is now specified that this case applies both if the reimbursements between spouses arise under an award of assets and also if the reimbursements are made in cash. It has also been specified that these reimbursements will not give the right to reduce the tax base of the payer or constitute income for the recipient.

1.6.2 Transfers for consideration – indexation allowance multipliers and abatement coefficients

(i) Elimination of indexation allowance multipliers

In transfers of real estate for consideration, the acquisition cost can no longer be updated by applying the indexation allowance multipliers (to adjust the acquisition cost for inflation).

(ii) Amendment of the rules on applying abatement coefficients

The previous Personal Income Tax Law substantially modified the rules on application of the so-called abatement coefficients. Specifically, with the entry into force of this Law, the application of those coefficients was eliminated but a transitional regime was provided, applicable to the assets acquired before December 31, 1994, consolidating the reduction applicable to the capital gains generated up until January 20, 2006 ("announcement effect" derived from the publication of the Preliminary Bill of the Law on January 19 of the same year) in the case of assets transferred on or after that date.

Thus, under that transitional regime, the gain must be calculated as follows:

(a) Firstly, the amount of the capital gain is calculated under the rules on determining gains in force in the fiscal year of the transfer.

(b) Of that amount, the portion of the gain generated before January 20, 2006 (in other words, up to and including January 19) must be determined, defined as the proportional part relating to the number of days elapsed between the acquisition date and January 19, 2006, with respect to the total number of days in which the item has remained in the taxpayer's assets.

(c) The portion of gain generated before January 20, 2006, is reduced by applying the abatement coefficients (where they apply, that is, for assets acquired before December 31, 1994):

- In the case of real estate or real estate companies, the gain is reduced by 11.11% per year elapsed since the acquisition of the asset up to December 31, 1994. The gains on real estate which on that date had been owned for longer than 10 years are not taxable.
- In the case of shares listed on secondary markets, except in the case of securities or real estate investment companies, the reduction is 25%. The gains on shares which on that date had been owned for longer than 5 years are not taxable.
- In other cases, the reduction is 14.28%. The gains on assets which on that date had been owned for longer than 8 years are not taxable.

(d) A special rule has been established for securities listed on any of the regulated markets and for shares and units in collective investment schemes. This special rule makes a distinction between two scenarios:

- If the transfer value exceeds the value of these securities for 2005 wealth tax purposes (average market value for the last quarter of 2005), the portion of the capital gain that will benefit from these abatement coefficients will be calculated as the difference between the acquisition cost and that value for 2005 wealth tax purposes; the rest of the gain will be taxed without any reduction.

- If the transfer value is below that used for 2005 wealth tax purposes, it will be considered that the entire gain was generated before January 20, 2006.

(e) The rest of the gain, that is, that deemed to be generated on or after January 20, 2006, will be taxed in full.

Now, under the current reform, and after initially announcing the complete elimination of the abatement coefficients, the Law has finally maintained the transitional regime but confined it to transfers carried out on or after January 1, 2015 (which are *a priori* entitled to apply the coefficients), in which the overall transfer price is below €400,000.

Accordingly:

(a) The coefficients can be applied as explained above, insofar as they do not exceed this aggregate transfer value.

(b) Where the aggregate transfer value for the transactions preceding the one under analysis (but carried out on or after January 1, 2015) is already €400,000 or higher, the coefficients cannot be applied.

(c) Lastly, where the actual transfer to be reported entails going from an aggregate transfer value below €400,000 to a value equal to or higher than that amount (for example, if all the previous transfers carried out since January 1, 2015 have been carried out at an aggregate value of €380,000 but the transfer generating the gain amounts to €100,000, which would take the aggregate amount to €80,000 above the specified limit), then a proportionality rule would have to be applied to determine the capital gain that can benefit from the coefficients.

Specifically, the reduction will be made on the portion of the gain generated before January 20, 2006 (calculated under the methods described above) relative to the portion of the transfer value which, when added to that of the previous transfers but carried out since January 1, 2015, does not exceed €400,000.

In the example used above, where

- Previous transfer values: €380,000

- Asset transfer value: €100,000,

The portion of the transfer value to be taken into account will be €20,000, which is the amount which, when added to the previous transfers, brings the total to the limit of €400,000 (€400,000 – €380,000).

Assuming that the capital gain relating to the period before January 20, 2006, is €80,000, the capital gain that could benefit from the coefficients would be:

80,000 x 20,000 /100,000 = 16,000

1.6.3 Specific valuation rules

(i) Transfer of subscription rights – listed securities

In the transfer for consideration of listed securities, the capital gain or loss is computed as the difference between the transfer value and the acquisition value, whereby the transfer value is determined as the market price or the agreed price, if higher.

To date, the authorities have been taking the view that to determine the acquisition cost, the amount obtained on the transfer of subscriptions rights must be deducted, unless that amount is higher than the acquisition cost from which those rights originate, in which case the difference will be a capital gain in the period in which the transfer takes place.

The amendment that has now been introduced determines that the amount derived from transfers of subscription rights must be considered, in all cases, a gain in the period in which that transfer takes place, without affecting the acquisition cost (as was already the case in transfers of unlisted securities or shares).

This new rule, however, will not become effective until January 1, 2017.

Therefore, a transitional regime is established under which, to determine the acquisition cost of listed securities, the amount obtained on transfers of subscription rights performed before January 1, 2017 must be deducted, except for any amount of those rights that might have been taxed as a capital gain, and it has been added that where not all the subscription rights have been transferred, the transferred rights will be taken to be those that were acquired first.

(ii) Transfers of unlisted securities or of shares or units in CISs

In cases of transfers of unlisted securities, unless it can be proven that the price paid is the market price, the transfer value cannot be lower than the higher of: (i) equity per the balance sheet for the latest fiscal year-end before the due date of the tax, and (ii) the result of capitalizing at 20% the average income/loss for the three fiscal years ended before the due date of the tax.

In the case of shares or units in CISs, the capital gain or loss is determined as the difference between the acquisition cost and the transfer value, whereby the transfer value is the net asset value on the transfer or redemption date (or, in the absence of that value, the latest published value). If there is no net asset value, the value of equity on the balance sheet for the latest fiscal year ended before the due date of the tax will be used.

The only amendment is the reference, in both cases, to equity on the balance sheet, as compared to the former law which referred to the "theoretical" value per the balance sheet.

Moreover, the special rule for transfers of units in investment funds listed on stock markets (whereby the transfer value will be determined according to the provisions in the law for transfers of listed securities) is extended to listed shares of the open-ended investment companies (SICAV) index, regulated in article 79 of the Regulations for Collective Investment Schemes Law 35/2003, of November 4, 2003 (Royal Decree 1082/2012, of July 13, 2003).

1.6.4 Reinvestment scenarios

In addition to the cases of exemption for reinvestment due to the transfer of the principal residence or of shares for which the tax credit for investment in new or recently formed companies has been taken, a new case of exemption is introduced for taxpayers over the age of 65, for the capital gains derived from the transfer of any of their assets, insofar as the total amount obtained on the transfer is used, within a six-month time period, to set up an insured life annuity to their benefit, on the conditions to 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 exempt from tax.

If all or any of the economic rights arising from the annuity that is set up are brought forward, the relevant capital gain will be taxed.

1.7 Inclusion and offset of income

The Law maintains the classification of the taxpayer's income into a general component and a savings component, but significantly changes the content of these types of income and the rules for inclusion and offset.

Specifically:

(i) The general component will continue to include salary income, income from immovable capital, the income from movable capital regulated in article 25.4 (intellectual property, industrial property, subleases, image rights, etc.), the income from movable capital derived from the transfer of capital to related entities that breach the thin capitalization ratios and the capital gains and losses that do not derive from asset transfers. But the Law removes from this category the capital gains or losses (derived from transfers) generated over a year or less.

(ii) The savings component will include the income from movable capital established in subarticles 1, 2 and 3 of article 25 (interests in the shareholders' equity of entities, the transfer of own capital to third parties, capital redemption transactions and insurance) and all the capital gains and losses arising from transfers of assets (including those generated over a year or less).

As regards income from movable capital that does not form part of the savings component of income (related to the financing of related entities), the percentage interest to be considered (to calculate the excess of own capital transferred to a related entity over the result of multiplying shareholders' equity by 3, in the portion that relates to the taxpayer's interest) will be 25% in cases where relatedness is not defined according to the shareholder-entity or member-entity relationship (5% in the former legislation).

The rules on including income, have been modified substantially:

(i) For the purpose of including income, four compartments are determined:

   (a) Income and imputed income in the general component of taxable income.

   (b) Capital gains and losses in the general component of taxable income.

   (c) Income (and losses) from movable capital in the savings component of taxable income.

   (d) Capital gains and losses in the savings component of taxable income.

(ii) The general component of taxable income is the result of adding together exclusively the balances of the first two compartments in the above list. However, if compartment (b) is a capital loss in the general component of taxable income, it must be offset against the positive balance of included income and imputed income, up to 25% of this positive balance (formerly, 10%). If the offset results in a loss, it may be offset in the following four years.

(iii) The savings component of taxable income is the result of adding together exclusively the balances of the last two groups in the above list. However, as a significant change, it is now allowed for the first time to offset the losses in each of these compartments against the positive balance of the other, up to 25%. In other words:

   (a) Taxpayers will be able to offset the negative balance after including and offsetting losses from movable capital against the positive balance obtained from the inclusion of the capital gains in the savings component of the taxable income, up to 25% of those gains,

   (b) and vice versa.

   Any negative balance resulting either from losses from movable capital or from capital losses may be offset in the following four years.

   These offset percentages among compartments will, however, be 10%, 15% and 20% in the 2015, 2016 and 2017 tax periods, respectively.

The new Law sets out the following transitional regime for losses and negative balances originating from prior years, summarized in the following table:

<table>
<tr><th colspan="2">Item available for offset</th><th colspan="2">Offset in or after 2015, against:</th></tr>
<tr><th>Fiscal year:</th><th>Item</th><th>Item</th><th>Trans. Prov 7, Sec. 7</th></tr>
<tr><td>2011-2012</td><td>Capital losses derived from transfers (without generation period requirement) available for offset as of January 1, 2013</td><td>Capital gains derived from transfer, regardless of generation period</td><td rowspan="5">No option for offset against each other IMC against capital G/L (25% limit established in art. 49.1)</td></tr>
<tr><td>2013-2014</td><td>Capital losses derived from transfers with generation period over 1 year, available for offset as of January 1, 2015</td><td>Capital gains derived from transfers, regardless of generation period</td></tr>
<tr><td>2011-2012</td><td>Capital losses not derived from transfers and available for offset as of January 1, 2013</td><td>Capital gains not derived from transfers (e.g., prizes)</td></tr>
<tr><td rowspan="2">2013-2014</td><td>Capital losses not derived from transfers and available for offset as of January 1, 2015</td><td>Capital gains not derived from transfers (e.g., prizes)</td></tr>
<tr><td>Capital losses derived from transfers with generation period of less than 1 year</td><td>Capital gains derived from transfers, regardless of generation period</td></tr>
</table>

In short, the rules may be summarized as follows:

(i) Any losses derived from the transfer of assets, regardless of their generation period (and of the year in which they were generated) may be offset against any capital gains derived from a transfer and regardless of their generation period.

(ii) Any capital losses not derived from a transfer (e.g., theft) may be offset against gains that are not derived from a transfer either (e.g., prizes).

(iii) The capital losses in the savings component in 2011-2014 cannot under any circumstances be offset against positive income from movable capital in or after 2015.

1.8 Net taxable income – Contributions to pension plans and similar systems

The structure for determining net taxable income remains unchanged, and is therefore divided as follows:

(i) General component of net taxable income, resulting from applying certain reductions to the general component of taxable income (with the elimination, as a new addition, of the reduction for membership fees and contributions to political parties). These reductions cannot bring the balance to below zero, and are:

(a) for contributions to employee welfare programs;

(b) for contributions to employee welfare programs set up to benefit people with disabilities;

(c) for contributions to protected assets of people with disabilities;

(d) for reimbursement alimony;

(e) for contributions to the welfare mutual insurance society for professional sportspersons.

(ii) Savings component of net taxable income, resulting from decreasing the savings component of taxable income by the remainder, if any, of the reductions for reimbursement alimony, to the extent these reductions do not bring the balance to below zero.

(iii) If the balance of the general component of net taxable income is negative, it may be offset against the positive balance of the general component of net taxable income in the following four years.

The main amendments introduced refer to the reduction for contributions to employee welfare programs. Accordingly:

(i) The aggregate maximum limit on the reductions for contributions to employee welfare programs will be whichever is higher of €8,000 (formerly, €10,000) and 30% of the sum of the salary income and income from economic activities received individually in the fiscal year. The increased limits of €12,500 and 50%, respectively, for taxpayers over the age of 50 are eliminated.

Specifically, in the case of private insurance premiums covering the risk of severe or comprehensive dependency, the total reductions made by all persons to the benefit of a single taxpayer (including those made by the taxpayer himself) are reduced from €10,000 to €8,000.

(ii) The new law increases from €2,000 to €2,500 the contributions made to the benefit of a spouse who does not obtain net salary income or income from economic activities or who obtains these types of income in an amount below €8,000 per annum which entitles the taxpayer to a reduction.

It must be noted that the €8,000 limit is also established for the aggregate maximum contributions by the taxpayer and by the employer to employee welfare programs (of those which give a right to the reductions in net taxable income). In other words, it is a financial and tax limit. Previously, the financial limit was €10,000 (€12,500 for taxpayers over the age of 50).

1.9 *Personal and family allowances*

The allowances for the taxpayer, and allowances for descendants and ascendants, in addition to the allowances for disability of the taxpayer and of his ascendants and descendants, are increased.

Specifically, the applicable allowances will be as follows:

		Former Law	Current Law
Personal allowance	General	5,151	5,550
	Taxpayer over the age of 65	6,069	6,700
	Taxpayer over the year of 75	7,191	8,100
Allowance for descendants[(i)]	One	1,836	2,400
	Two	2,040	2,700
	Three	3,672	4,000
	Four and above	4,182	4,500
Allowance for ascendants[(ii)]	Over 65 or with a disability (regardless of age)	918	1,150
	Over 75	2,040	2,550
Allowance for disability[(iii)]	Disability of 33% or greater but below 65%	2,316	3,000
	Disability of 33% or greater but below 65% and evidences need for assistance by third persons or of reduced mobility	4,632	6,000
	Disability of 65% or greater	9,354	12,000

(i) Persons with a relationship to the taxpayer by reason of guardianship and foster care are treated as descendants. Where the descendent is below 3 years of age, the allowances will be increased by €2,800 per annum (formerly, €2,244 per annum).

(ii) The ascendant must live with the taxpayer and not have annual income, other than exempt income, above €8,000.

(iii) The amounts refer to both the allowance for disability of the taxpayer and to the allowance for disability of descendants and ascendants.

It continues to be established in the law that to apply the allowances, the personal and family circumstances on the due date of the tax must be taken into account. However, in the case of the death of a descendant or, as a new addition, an ascendant, who generates the right to the allowance, the amount will be €2,400 (formerly, €1,800) or €1,150 per annum, respectively.

In the case of the death of an ascendant, he must have lived with the taxpayer for at least half of the period elapsed between the first day of the tax period and the date of death.

1.10 *Tax rates*

The added amendments consist basically of lowering the tax rates from those applicable in 2014, but gradually (although without completely eliminating the supplementary tax charge created temporarily for 2012, 2013 and 2014).

In particular, the amount the general component of net taxable income that is above the personal and family allowances will be taxed according to a central government scale and an autonomous community scale of rates which, in the absence of approval of the tax by the respective autonomous community will be as follows (comparative figures for last year are provided):

	Scale prior to 2012			Scale for 2012, 2013 and 2014		
Net taxable income	**Tax due**	**Rest of base**	**Rate**	**Tax due**	**Rest of base**	**Rate**
0.00	0.00	17,707.20	24%	0.00	17,707.20	24.75%
17,707.20	4,249.73	15,300.00	28%	4,382.53	15,300.00	30%
33,007.20	8,533.73	20,400.00	37%	8,972.53	20,400.00	40%
53,407.20	16,081.73	66,593.00	43%	17,132.53	66,593.00	47%
120,000.20	44,716.72	55,000.00	44%	48,431.24	55,000.00	49%
175,000.20	68,916.72	Thereafter	45%	75,381.24	125,000.00	51%
300,000.00	N/A	N/A	N/A	139,131.24	Thereafter	52%

	Scale 2015			Scale from 2016 onwards		
Net taxable income	**Tax due**	**Rest of base**	**Rate**	**Tax due**	**Rest of base**	**Rate**
0.00	0.00	12,450.00	20%	0.00	12,450.00	19%
12,450.00	2,490.00	7,750.00	25%	2,365.50	7,750.00	24%
20,200.00	4,427.50	13,800.00	31%	4,225.50	15,000.00	30%
34,000.00	8,705.50	26,000.00	39%	N/A	N/A	N/A
35,200.00	N/A	N/A	N/A	8,725.50	24,800.00	37%
60,000.00	18,845.50	Thereafter	47%	17,901.50	Thereafter	45%

The amount of the savings component of net taxable income that is above the personal and family allowances will be taxed according to the following scale (central government and autonomous community):

Savings component of net taxable income – up to euros	Scale before 2012	Scale in 2012-2014	Scale in 2015	Scale in 2016
Up to 6,000	19%	21%	20%	19%
From 6,000 to 24,000	21%	25%	22%	21%
From 24.000 to 50.000	21%	27%	22%	21%
50,000 and above	21%	27%	24%	23%

Lastly, the following changes are made in relation to the special rules on child support payments (calculation of the tax payable by applying separately the central government and autonomous community rate tables to the amount of the payments and to the rest of the net taxable income):

(i) This regime will only apply to taxpayers who pay child support for their children under a court order and do not have the right to apply the allowance for descendants in relation to those children.

(ii) The personal and family allowance of the taxpayer will be increased to €1,980 per annum (formerly, €1,600).

1.11 Tax credits

1.11.1 Tax credit for investment in the principal residence

The transitional rules remain unchanged for acquisitions made before January 1, 2013.

1.11.2 Tax credit for economic activities

The tax credit for investment of income (for taxpayers that meet the requirements established in the corporate income tax regime for companies of a reduced size) remains unchanged but is lowered generally from 10% to 5%. Additionally, it is lowered from 5% to 2.5% in the case of income obtained in Ceuta and Melilla with respect to which the tax credit established for this type or income had been applied or where the tax credit for commencement of an economic activity under the direct assessment method had been taken (article 31.3 of the Law).

It must be remembered that this tax credit is taken when the net income from activities in the period is invested in new items of property, plant and equipment or investment property used in activities carried out by the taxpayer, and that the tax credit base is the amount invested.

1.11.3 Tax credit for donations

The Law maintains the provision that the tax credits established in Law 49/2002, of December 23, 2002, on the tax regime for not-for-profit entities and on the tax incentives for patronage, will be applicable and that a tax credit of 10% will apply for amounts donated to legally recognized foundations that report to the relevant Foundations Commission, and to the associations declared to be of public interest, not included in the scope of application of Law 49/2002.

Worth noting is that the new Corporate Income Tax Law (which we summarize in another commentary but which also affects personal income taxpayers) amends that Law 49/2002:

(i) By increasing the tax credit rate, to 75% for the first €150 and to 30% for the rest (transitionally for 2015, these rates will be 50% and 27.5%, respectively).

(ii) By encouraging donor loyalty through an increase in the tax credits if, in the two immediately preceding tax periods, donations have been made to the same entity, in each of those years, for the same amount or higher than that of the preceding year. In these cases, the tax credit rate applicable to the tax credit base in favor of that same entity exceeding €150 will be 35% (transitionally for 2015, this rate will be 32.5%).

Additionally, a 20% tax credit is created for membership fees and contributions to political parties, electorate federations or groups, applicable to a maximum base of €600 per annum. This tax credit replaces the reduction (in taxable income) in respect of membership fees and contributions to political parties.

1.11.4 Tax credit for income obtained in Ceuta and Melilla:

To be able to take the tax credit for income originating from companies that effectively and physically operate in Ceuta and Melilla, that income must be income to which the tax reduction established in the corporate income tax legislation applies.

1.11.5 Tax credit for investment in newly or recently created companies

In relation to this tax credit, which is maintained and which, you are reminded, is 20% of the amounts paid for the subscription of shares or units in newly or recently created companies (where certain requirements are met), the law establishes that the tax credit base (still capped at €50,000) cannot include the amount of the shares or units acquired with the balances of business start-up savings accounts insofar as a tax credit has been taken in respect of that balance.

1.11.6 Tax credit for large families or dependent family members with disabilities

New tax credits are created for "large families or dependent family members with disabilities " according to which, taxpayers that meet the requirements of (i) performing an activity on a self-employed or employed basis, (ii) in relation to which they are registered under the relevant social security regime or a member of a mutual insurance society, can reduce their tax liability balance by applying certain tax credits, capped at €1,200 in all cases:

(i) for each descendant with a disability eligible for the allowance for descendants;

(ii) for each ascendant with a disability eligible for the allowance for ascendants;.

(iii) due to being an ascendant or orphaned brother or sister (i.e. no father or mother), forming part of a large family.

The main elements to be noted in relation to the tax credits are:

(i) They will be calculated proportionally relative to the months in which the above requirements are met.

(ii) Each tax credit will be subject to a limit determined by the total (without subtracting reductions) contributions and payments that became due to the social security system and mutual insurance societies in each period. But if the taxpayer is entitled to the tax credits for ascendants or descendants with disabilities in respect of two or more ascendants or descendants, that limit will apply separately with respect to each one.

(iii) The tax credits will be increased by 100% in cases of large families falling within a special category; this increase will not be taken into account for the purposes of the above limit.

(iv) If the taxpayer is entitled to the tax credit for two or more ascendants or descendants with disabilities, the above limit will apply separately with respect to each one.

The tax credits may be paid in advance, in which case they will not reduce the taxpayer's tax liability balance.

Lastly, the law provides that regulations may be introduced with rules on the transfer of the right to apply the tax credits between the taxpayers who are entitled to them in relation to the same descendant, ascendant or large family.

1.11.7 Elimination of tax credits

The following tax credits are eliminated:

(i) Tax credit for business start-up savings accounts.

(ii) Tax credit for the obtaining of salary income and income from economic activities.

(iii) Tax credit for rental of a permanent residence. Although in this case, it is retained on a transitional basis for taxpayers who entered into a lease agreement before January 1, 2015, under which they have satisfied, before that date, rental payments for their permanent residence, insofar as the taxpayer was entitled to the tax credit in relation to the sums paid for rental of that residence which fell due in a tax period before January 1, 2015.

1.12 International fiscal transparency

This regime undergoes significant changes:

(i) It is established, first of all, that all the income derived from the assignment or transfer of assets or rights, or from the provision of services must be attributed to the taxpayer, where the nonresident company does not have the relevant organization of human and material resources to perform the transactions in question (even if the transactions are recurring).

However, this obligation will not apply where it is evidenced that the taxpayer has human and material resources at another nonresident entity in the same group, or that there are valid economic reasons for the formation and operations of the entity.

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

(ii) Only if the provisions in the above point do not apply, and if the requirements to apply the regime are met, will the taxpayer only have to be attributed the income derived from the sources currently specified (ownership of real estate not used in economic activities, interest in the shareholders' equity of entities and transfer of own capital to third parties, together with lending, financial and insurance activities and activities related to providing services). The new amendments, however, have added income from the following sources (i) capital redemption and insurance transactions having legal entities as their beneficiaries; (ii) intellectual and industrial property, technical assistance, movable property or image rights (unless the special attribution regime applies to this income); and (iii) financial derivative instruments.

In relation to any lending, financial and insurance activities or activities related to providing 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, it is specified 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) Regardless of the requirement for attribution due to an absence of human and material resources, in the case of dividends, shares in income or gains on the transfer of shares, no attribution will be required in the case of securities derived from an interest in the capital or in the shareholders' 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 controlling and managing the interest, insofar as the relevant organization of material and human resources exists, and (iv) the investee's primary activity is not the management of movable or immovable property on the terms established in article 4.Eight.Two.a) of Wealth Tax Law 19/1991, of June 6, 1991.

If the entities form part of the same corporate group (as defined in article 42 of the Commercial Code) and regardless of residence and the obligation to prepare consolidated financial statements, the requirements regarding the percentage ownership as well as the existence of control and management of the interest will be determined by reference to all of the entities forming part of the group.

(iv) The envisaged case of exclusion of the income derived from the sources currently set out 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 derived from lending, financial and insurance activities and activities related to provisions of services, which will be attributed in full.

(v) The option to elect to include the attributed income in the tax period in which the financial statements are approved is eliminated.

(vi) The place of the tax domicile and the notes to the financial statements of the nonresident entity have been included among the information to be filed with the return.

(vii) The presumption established for tax havens is extended to apply to no-tax countries or territories.

(viii) The attribution regime will not apply where the non-Spanish resident entity is resident in another EU member state insofar as the taxpayer evidences that there are valid economic reasons for its formation and operations and that it engages in economic activities, or is a collective investment scheme (or undertaking) regulated under 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 undertakings for collective investment in transferable securities, other than those provided for in article 95 of the Personal Income Tax Law, formed and domiciled in an EU member state.

1.13 Special inbound expatriates regime

Significant changes are introduced in this regime which, readers are reminded, allows persons who become tax resident in Spain as a result of their assignment to Spain to elect to pay nonresident income tax in the year in which they change their residence and the following five years:

(i) First of all the regime (i) does not apply to professional sportspersons subject to Royal Decree 1006/1985, but (ii) does include taxpayers who are assigned to Spain because they have become director of an entity in whose capital they do not hold an interest or, otherwise, where the interest does not give rise to related entity status.

(ii) With respect to the requirement that stipulates that the taxpayer must not have been resident in Spain before his assignment to Spain, the reference to the ten "years" preceding that in which the assignment occurs, has been replaced with reference to the ten preceding "tax periods".

(iii) The requirements that the work must actually be performed in Spain, that the work must be performed for an enterprise or entity resident in Spain and that the salary income must not be exempt from nonresident income tax are eliminated.

(iv) The quantitative requirement that the expected compensation must not exceed €600,000 per year is also eliminated.

(v) It is established that the tax debt will be determined according to the rules laid down in the revised Nonresident Income Tax Law for income obtained other than through a permanent establishment, subject to a number of special rules:

(a) The exemptions established in the nonresident income tax legislation will not apply.

(b) All of the taxpayer's salary income will be deemed to be obtained in Spain.

(c) The income obtained during the calendar year will be taxed cumulatively, without being able to offset one item against another.

(d) The dividends, interest and capital gains on asset transfers will be taxed separately from other income, according to the scale already mentioned for savings income: 19%, 21% and 23%. On a transitional basis in 2015, however, the rates will be 20%, 22% and 24%.

(e) The other income will be taxed according to the following scale:

Net taxable income	Rate in 2015	Rate in 2016
Up to €600,000	24%	24%
€600,000.01 and above	47%	45%

(f) The withholding tax rate for salary income will be 24%. However, where the compensation paid by the same payer in the calendar year exceeds €600,000, the withholding rate applicable to any excess will be 45% (47% in 2015).

Taxpayers who have been assigned or relocated to Spain before January 1, 2015 may elect to apply the regime in force as of December 31, 2014.

1.14 Capital gains due to change of residence ("exit tax")

A new regime is added to the Law whereby, in the case of those who forfeit their personal income taxpayer status due to a change of residence, any positive differences between the market value of the shares held by the taxpayer in any type of entity and their acquisition value will be treated as capital gains (in the savings component of taxable income), insofar as the taxpayer has had personal income taxpayer status for at least ten of the fifteen tax periods preceding the last tax period for which he must file a return for this tax and either of the following circumstances are present:

(i) The combined market value of the shares exceeds €4,000,000.

(ii) Otherwise, on the due date for the last tax period for which a personal income tax return must be filed the interest in the entity is greater than 25%, insofar as the market value of the shares in that entity exceeds €1,000,000. In this case, this regime will only apply to the shares in these entities.

In the case of taxpayers who have elected the special regime applicable to workers assigned to Spain, the above-mentioned ten-year period will start to run from the first tax period in which that special regime does not apply.

The capital gains will be attributed to the latest tax period for which a personal income tax return must be filed. If necessary, a supplementary return will be filed, with no penalty, late-payment interest or surcharge whatsoever.

The capital gain will be determined on the basis of the market value of the shares, which, (i) in the case of listed shares, will be their market price, and (ii) in the case of unlisted shares, will be the higher of equity per the balance sheet for the latest fiscal year-end before the due date of the tax and the result of capitalizing at 20% the average of the income/loss for the three fiscal years ended before the due date of the tax (computing any dividends distributed and allocations to reserves, except for those made to the asset revaluation reserve). For their part, (iii) shares or units in collective investment schemes will be valued at the net asset value as of the due date for the latest period for which a personal income tax return must be filed or, failing that, at the latest net asset value to be published (if none has been published, at the value of equity per the balance sheet for the latest fiscal year-end before the due date of the tax, unless a different market value is evidenced).

However (on the conditions that will be established by regulations), where the change of residence occurs as a result of a temporary assignment for work reasons to a country or territory that is not considered a tax haven or for any reason, insofar as in this case the temporary assignment is to a country or territory that has signed a tax treaty with Spain containing an information exchange provision, following a request by the taxpayer, the tax authorities will defer the payment of the tax debt relating to these capital gains. The deferral will expire at the latest on June 30 of the year following the end of the five-year period following the last one in which a personal income tax return must be filed.

In the case of assignments or relocations for work reasons, the taxpayer has been given the option to ask the tax authorities to extend that five-year period where there are circumstances justifying a longer temporary assignment, although the extension cannot under any circumstances be longer than an additional five fiscal years.

Where the change of residence is to another member state of the EU or the European Economic Area with which there is an effective exchange of tax information, the taxpayer may elect to apply certain special rules to the capital gains:

(i) The taxpayer can elect for the gain to be self-assessed only where in the ten years following the last year for which a personal income tax return must be filed, (i) the shares are transferred *inter vivos*, (ii) the status of resident of an EU member state or of the European Economic Area is forfeited, or (iii) certain disclosure obligations are breached. In these cases, the gain will be reported in the latest period for which a personal income tax return must be filed (if applicable by way of a supplementary return) without any penalty, surcharges or interest.

(ii) In the case referred to above of an *inter vivos* transfer of shares, the gain will be reduced by the positive difference between its market value and its transfer value (which in turn will be increased by any distributed income or other received payments that have reduced the entity's equity after taxpayer status has been forfeited, unless they have been taxed in respect of nonresident income tax).

In this case, where the individual reacquires taxpayer status, these special rules will no longer apply, unless any of the circumstances triggering the obligation to file a self-assessment for the capital gain have arisen.

This regime will also apply where the change of residence is to a country or territory considered a tax haven and the taxpayer does not forfeit his resident status in accordance with article 8.2 of the Personal Income Tax Law, also subject to certain special rules.

1.15 Managing the tax

1.15.1 Tax return threshold

The threshold has been raised from €11,200 to €12,000 in order for no tax return to be required in cases where (i) income is obtained from more than one payer, (ii) nonexempt reimbursement alimony and spousal and ascendant/descendant support payments are received, (iii) the payer is not required to pay withholding tax, or lastly (iv) salary income subject to fixed withholding tax rates is received.

1.15.2 Withholding taxes

(i) It is clarified that the taxpayer can deduct the amount of withholding tax that should have been paid where this was not done, or the amount paid in this respect was lower than it should have been for a reason attributable exclusively to the withholding agent (the word "exclusively" has been introduced).

(ii) On or after January 1, 2017, in transfers of preemptive subscription rights for shares or units in collective investment vehicles, the custodian entity and, in the absence thereof, the financial intermediary or the public authenticating official who has attested the transfer, will be required to withhold the tax.

(iii) A withholding tax scale for salary income has been added, split into five brackets with rates between 19% and 45%. In the case of delays, the withholding rate is set at 15% (identical to those indicated in the "Tax rates" section combining the central government and autonomous community scales).

(iv) The withholding rate for directors and board members is set at 35% (37% in 2015) and is lowered to 19% (20% in 2015) where the income originates from entities with net revenues below €100,000.

(v) The withholding rate for salary income from participating in courses, conferences, talks, seminars or the like, or from preparing literary, artistic or scientific works, insofar as the right to exploit them is licensed, is set at 18% (19% in 2015). This rate will be reduced by half in the case of salary income obtained in Ceuta and Melilla that qualifies for the tax credit for income obtained in Ceuta and Melilla.

(vi) The withholding rate for income from professional activities is set at 18% (19% in 2015).

(vii) Royal Decree-law 8/2014, of July 4, 2014, approving urgent measures for growth, competitiveness and efficiency (confirmed by Law 18/2014, of October 15, 2014), established the 15% reduced rate for income from professional activities, but subject to the requirements that (i) the maximum gross income from professional activities in the immediately preceding year must be below €15,000, and (ii) it must represent more than 75% of the sum of the taxpayer's gross income from economic activities and salary income for that year.

This reduced withholding rate has now been added to the Law on the same terms as provided for in that Royal Decree-Law and in Law 18/2014.

(viii) With effect from January 1, 2017, the withholding rate for capital gains arising on transfers of preemptive subscription rights is set at 19%.

1.15.3 Reporting requirements

Reporting requirements are added or broadened in relation to:

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

(ii) Entities that market long-term savings plan (PALP) contracts.

(iii) Autonomous communities and the Senior Citizens and Social Services Institute, with respect to individuals who fulfill the large family requirements, and to information on the degree of disability of people with disabilities.

(iv) Entities that distribute additional paid-in capital or reduce capital with repayment of contributions, in relation to distributions made that are not subject to withholding tax.

(v) Taxpayers who own protected assets regulated under Law 41/2003, of November 18, 2003.

1.16 Voluntary disclosures in relation to foreign pensions

The option of making voluntary disclosures without incurring surcharges, interest or penalties, by filing supplementary self-assessments has been provided for personal income taxpayers who have received foreign pensions subject to personal income tax and have not reported that income in the tax periods for which the voluntary filing period has ended on the date of entry into force of this legislation.

Voluntary disclosures for non-statute-barred tax periods must be made between the date of its entry into force and June 30, 2015, and this period cannot be extended.

If the inclusion of these pensions means that a taxpayer becomes required to file a personal income tax return, the voluntary disclosure must be made by filing the relevant tax return, specifying the total income obtained in that fiscal year.

For this regime to apply, the supplementary return or self-assessment filed must be accompanied by the form that will be available for the purpose on the State Tax Agency's website. The payment of the resulting tax debt may be deferred or split into installments.

Regardless of whether or not they have become final, the following will be forgiven under the provisions in this legislation:

(i) Surcharges, interest and penalties in connection with 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 legislation.

(ii) Tax penalties in connection with assessments in which that income has been disclosed before the entry into force of this legislation.

(iii) Surcharges from the enforcement period and late-payment interest accrued from the start of the enforcement period assessed in this connection.

If the assessment of the surcharges, interest and penalties has become final, the taxpayer must request for them to be forgiven by the tax authorities within the non-extendible period between the entry into force of this provision and June 30, 2015, providing sufficient identification of 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 in the proportion the included pensions bear to the other income being disclosed.

However, if the inclusion of the pensions means that a taxpayer becomes required to file a personal income tax return, the full amount of surcharges, interest and penalties will be forgiven.

Any amounts paid over in respect of interest, surcharges and penalties will be refunded without late-payment interest within six months following the filing of the request. If the refund is not made within that period, the tax authorities will pay the relevant late-payment interest.

2. Inheritance and gift tax

The amendment of this tax originates from a judgment handed down by the Court of Justice of the European Union on September 3, 2014 (case C-127/12) which determined that Spain had breached EU law by allowing differences in the tax treatment of gifts and inheritances according to whether (i) the successors and recipients are Spanish resident or not, (ii) the decedents were Spanish resident or not and (iii) the gifts and similar disposals of real estate were located in Spain or not.

The Inheritance and Gift Tax Law is therefore amended to introduce a number of rules that eliminate the cases of discrimination found by the court, thereby placing the tax treatment of residents and nonresidents on an equal footing.

The new connecting factors with the autonomous community legislation are as follows:

(i) Where the **decedent** has been **resident in a member state of the EU or of the European Economic Area**, other than Spain, taxpayers will be entitled to apply the specific legislation approved by the autonomous community in which the assets and rights with highest value are located among the assets and rights in the estate located in Spain. If there are no assets or rights located in Spain, each taxable person will be subject to the legislation of the autonomous community where he resides.

(ii) Where the **decedent** was **resident in an autonomous community** and the taxpayers are not resident there but reside in a member state of the EU or of the European Economic Area, the taxpayers will be entitled to apply the specific legislation approved by that autonomous community.

(iii) Where **real estate located in Spain** is acquired by gift or in any other legal transaction for no consideration and *inter vivos*, nonresident taxpayers who are resident in a member state of the EU or of the European Economic Area will be entitled to apply the specific legislation approved by the autonomous community where that real estate is located.

(iv) Where **real estate located in a member state of the EU or the European Economic Area**, other than Spain, is acquired by gift or in any other legal transaction for no consideration and *inter vivos*, taxpayers resident in Spain will be entitled to apply the specific legislation approved by the autonomous community where they reside.

(v) Where **movable property located in Spain** is acquired by gift or in any other legal transaction for no consideration and *inter vivos*, nonresident taxpayers who are resident in a member state of the EU or the European Economic Area will be entitled to apply the

specific legislation approved by the autonomous community where the movable property has been located for the greatest number of days within a period comprising the immediately preceding five years, reckoned from date to date, which ends on the day before the tax falls due.

For the purposes of the above rules, individuals resident in Spain will be deemed to be resident in an autonomous community where they have spent the greatest number of days in that autonomous community in the period comprising the immediately preceding five years, reckoned from date to date, which ends on the day before the tax falls due.

Where in a single document different assets or rights are given to the same recipient by one giver, and the above rules determine that the legislation of different autonomous communities applies, the tax payable will be determined as follows:

(i) The average tax rate must be calculated by applying to the value of all the given assets and rights the legislation of the central government and the legislation of each autonomous community where a part of those assets and rights is located.

(ii) Then by applying the average rate obtained under its own specific legislation to the value of the assets and rights that are located in each autonomous community, the tax payable will be determined in respect of those assets and rights.

Any taxpayers required to fulfil their inheritance and gift tax obligations with the central government tax authorities:

(i) must file a self-assessment, and perform the necessary transactions to determine the amount of the tax debt;

(ii) must attach the document or statement containing or evidencing the taxable event;

(iii) must, when filing their self-assessment, pay over the resulting tax debt in the place, manner and time periods determined by regulations.

3. Wealth tax

With the same aim as in the case of inheritance and gift tax, the following wealth tax rule is introduced to allow similar treatment between residents and nonresidents who are resident in other member states of the EU or the European Economic Area.

Specifically, nonresident taxpayers who are resident in a member state of the EU or of the European Economic Area will be entitled to apply the specific legislation approved by the autonomous community where the value of the assets and rights that are owned by them and subject to wealth tax because they may be exercised or must be fulfilled in Spain, is highest.

4. Nonresident income tax

Various changes are made to the nonresident income tax legislation, effective from January 1, 2015, including most notably the following:

4.1 Exemptions

4.1.1 Exemption for capital gains on the transfer of shares or other rights in an entity, obtained by EU residents or by permanent establishments of those residents located in another EU member state.

To date, this exemption did not apply where (i) the assets of the entity in question mainly consisted directly or indirectly of real estate situated in Spain, and (ii) where at some point in the 12 months preceding the transfer, the taxpayer (individual or legal entity) had owned a direct or indirect interest of at least 25% in the capital or equity of the entity.

The new wording of the law maintains exception (i) but with respect to (ii) it limits it exclusively to individuals.

In addition, a third restriction is introduced for cases where the transfer does not meet the requirements for applying the exemption for the avoidance of double taxation (domestic and international) set out in the corporate income tax legislation.

4.1.2 Exemption for distributions of dividends to parent companies resident in the European Union or in the European Economic Area

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 owning an interest in its subsidiary with an acquisition cost higher than €20 million. 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 under article 42 of the Commercial Code for entities to form part of the same group of companies, regardless of residence and the obligation to file consolidated financial statements.

A change is made to the conditions for the exemption of distributions of dividends to parent companies resident in the member countries of the European Economic Area.

In particular, if to date those parent companies were required to be resident in a state which had "signed with Spain a tax treaty containing an exchange of information clause or an agreement for the exchange of tax information", now the provision is worded so as to require residence in a country with an "*effective exchange of tax information*", on the new terms introduced in additional provision one of Law 36/2006 on measures to prevent tax fraud, mentioned below.

Lastly, the Law amends the anti-abuse clause currently existing for distributions of dividends to parent companies resident in the European Union not only to include within its scope of application residents of the states in the European Economic Area on the terms of the preceding paragraph, but also to allow the application of the exemption exclusively "*where the formation and operations of the former (the company receiving the dividend) are for valid economic reasons and business reasons with substance.*"

4.1.3 Exemption for royalty payments to associated enterprises resident in the EU

This anti-abuse clause is amended to the same effect as for the dividend distributions mentioned above, in order to allow the application of the exemption exclusively ”where the formation and operations of the former (the company receiving the royalty) are for valid economic and substantive business reasons other than the management of securities or other assets.”

4.1.4 Exemption for dividends

As in the Personal Income Tax Law, the exemption of up to €1,500 for dividends obtained by certain nonresident individuals is eliminated.

4.1.5 Capital gains obtained by a resident in the European Union or in a member state of the European Economic Area

Capital gains obtained by a resident in the European Union or in a member state of the European Economic Area with which there is an effective exchange of tax information, generated on transfers of real estate that have been used as the principal residence of a non-Spanish resident will be tax exempt if the proceeds obtained on the transfer are reinvested in another principal residence, and under the same conditions as those applicable to Spanish tax residents.

Nonetheless, this exemption does not preclude the requirement for withholding tax equal to 3% of the transfer price on transfers of real estate by nonresidents, nor does it release the nonresident from the obligation to file a tax return and pay over the tax debt although, if the reinvestment takes place before the transfer, it may be taken into account in order to determine the related tax debt.

4.2 Tax base

4.2.1 Valuation of transactions

The Nonresident Income Tax Law now includes the obligation stipulated under the Corporate Income Tax Law to include in the tax base the difference between the normal market value and the book value of items which are used by a permanent establishment that discontinues its activity or which are transferred abroad.

4.2.2 Capital gains on the transfer of shares

In the case of capital gains on the transfer of shares obtained by nonresidents who would previously have been subject to the new tax regime due to a change of residence, it is expressly stipulated that the capital gain is to be computed by taking as the acquisition cost the market value of the shares used for the purposes of computing the capital gain set out in that new regime.

4.2.3 Determination in the case of residents in the European Union

A change is made to the rules for determining the tax base of taxpayers resident in the EU, which to date allows both individuals and legal entities to deduct the expenses stipulated in the Personal Income Tax Law, insofar as they prove that the expenses are directly related to income obtained in Spain and bear a direct and inseparable economic relationship to the activity performed in Spain.

These rules now also apply to residents of a member state of the European Economic Area with which there is an effective exchange of tax information.

It is also stipulated that their actual status as an individual or legal entity must be taken into account, since, in the case of legal entities, the legislation to be applied for the deduction of expenses is the Corporate Income Tax Law, with the same requirements regarding proof and relationship with the activity performed in Spain as those currently in force.

4.3 Tax rates

(i) The tax rate for permanent establishments will be determined by applying the Corporate Income Tax Law.

(ii) The supplementary tax charge for income obtained and transferred abroad by permanent establishments will be levied at a rate of 20% in 2015 and 19% from 2016.

(iii) With respect to income obtained other than through a permanent establishment, the standard tax rate, which to date was 24.75%, (i) is reduced to 24%, and (ii) to 19% from 2016 (20% in 2015) for residents in the European Union or in a member state of the European Economic Area with which there is an effective exchange of tax information, in line with the reduction of the minimum tax rate on the standard personal income tax scale.

The Law thus brings the standard tax treatment of EU residents into line with the existing treatment for dividends, interest and capital gains on the transfer of assets, which will also be 19% from 2016 (20%, in 2015).

(iv) The tax rate of pass-through tax entities with a presence in Spain is set at 25%.

4.4 Other amendments

(i) The regime under which taxpayers resident in other EU member states can choose to be taxed for personal income tax is extended to be available to residents of a member state of the European Economic Area with which there is an effective exchange of tax information, and the eligible cases are broadened to include a case in which the taxpayer has obtained in Spain income lower than 90% of the personal and family allowance to which he would have been entitled had he been tax resident in Spain, and the income obtained outside Spain was also below that allowance.

(ii) In line with the amendment made to corporate income tax, a provision is included to tax income attributed to the head office or to a permanent establishment of the head office outside Spain which relates to estimated expenses in respect of domestic transactions in accordance with the provisions of a tax treaty.

(iii) The "definition of tax haven, no-tax [countries or territories] and effective exchange of tax information" is amended (with the resulting impact on various taxes and not only on nonresident income tax) in order to include new criteria updating the list of tax havens and, in particular, the possibility for countries or territories treated as tax havens to sign the "OECD Convention of Mutual Administrative Assistance in Tax Matters amended by the 2010 Protocol" or the findings of the "peer reviews" performed by the Global Forum on Transparency and Exchange of Information for Tax Purposes.

The amendment also enables the government to update the list of countries and territories treated as tax havens.

(iv) A "draft return" is created which may be requested by taxpayers who obtain imputed income from real estate, for each property that gives rise to such income and which will merely be for information purposes and will not release the taxpayer from his obligation to file a return for this income.

5. Changes in the Pension Plans and Funds Law

The Law regulates a new case in which taxpayers can cash in their contributions to pension plans.

Specifically, it is established that the right to realize vested rights will apply not only in cases of (i) long-term unemployment and (ii) serious disease, but also (iii) where the contributions were made more than ten years earlier. Therefore, it will be possible to cash in contributions to pension plans, insured provident plans, corporate employee welfare programs and insurance contracts arranged with welfare mutual insurance societies that were made at least ten years earlier, as well as the income generated by those contributions. The terms, conditions and limits on which the vested rights can be realized will be established by regulations.

Accordingly, it is established that:

(i) with respect to contributions to pension plans, starting January 1, 2025, the vested rights existing as of December 31, 2015 may be realized with the income relating to them; and

(ii) the above provision also applies to vested rights derived from premiums and contributions paid before January 1, 2016 to insured provident plans, corporate employee welfare programs and insurance contracts arranged with welfare mutual insurance societies.

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

Entities will have until December 31, 2015 to adapt their procedures for transferring vested or economic rights for the purposes of including the information on the amount of the contributions that give rise to the rights being transferred and the dates on which they were realized. With respect to contributions paid before January 1, 2016, it will suffice to report the amount of the vested or economic rights being transferred that relate to them.

6. Entry into force

The Law enters into force on January 1, 2015 except in certain cases in which it is postponed to January 1, 2016 or January 1, 2017 or in which it is brought forward to the day following that of its publication in the Official State Gazette (all of which have been specified in this Commentary).

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