GARRIGUES

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Tax benefits for reinvesting extraordinary income (now, a tax credit, a few years ago, an exemption, and later deferral relief) usually come under the taxman's scrutiny because they reduce the effective tax rate. As things stand, the appropriate reinvestment can bring the effective tax rate for capital gains down from the 30%, standard rate to 18%.

Coming under examination are issues relating to transferred assets or the assets in which the reinvestment is made. The taxman looks in particular at whether the necessary requirements are fulfilled, such as whether the assets are being used in the business activity, whether they are indeed fixed assets, or whether the minimum holding percentages are met in cases of transfer or reinvestment in securities. Checks are also made as to whether the reinvestment periods have been observed, whether the income on which the tax credit is sought to be taken has been calculated correctly, and any other aspect that might affect this tax credit.

In this Newsletter, we will discuss various recent rulings and judgments that examine some of these aspects. For example, we discuss three recent judgments by the National Appellate Court, all dated December 1, 2011, which contain the following interpretation:

- Transfers of stock options do not qualify for the tax credit, as those transactions do not imply the transfer of investments in equity but rather of options on the assets created by those investments (and the rights attached to them).

- The fact of changing the accounting classification of the assets from fixed assets to assets held for sale before their transfer does not prevent the tax credit from being taken, as long as they were used as fixed assets in the business activity until they were reclassified.

- The tax credit cannot be taken for transfers of assets initially acquired to be leased out if the leasing activity has not started (even if the taxpayer had intended to carry on the activity). The National Appellate Court has underlined the importance for these purposes of the assets actually being used in the activity, not simply the taxpayer's intention to use them.

Also discussed below is ruling V2802-11, of November 25, 2011, by the Directorate-General of Taxes (DGT), which takes a look at how to calculate the tax credit base and the amount to be reinvested in cases of transfers with deferred payment. Under accounting rules, the agreed price in these cases is treated as having a principal component (the actual value of the agreed price) and a financial component (the implicit interest derived from the deferred payment), and it is the principal component that can be reinvested and must be used to calculate the income on which the tax credit is determined.

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1. JUDGMENTS

1.1 Corporate income tax.- Amounts incorrectly deducted in statute-barred years cannot be corrected nor can penalties for their use be levied in non-statute-barred years (Supreme Court. Judgments of December 12 and 19, 2011, among others)

The Supreme Court has issued a number of judgments recently which support the view that penalties cannot be levied for using credits that were reported incorrectly in statute-barred years.

In judgments dated December 12 and 19, 2011, the court analyzed the case of a taxpayer which, in a non-statute-barred fiscal year under inspection, had taken credits reported in years that were statute-barred. The inspectors issued an assessment and initiated a penalty proceeding for the incorrect use of those credits.

Although in these cases the penalty proceedings were analyzed, the Supreme Court recalled that, as it had already held in judgments dated September 15, 2011 or February 25, 2010 (which in turn referred to the Supreme Court's judgments of January 30, 2004 and March 17, 2008), an assessment becomes final when it becomes statute-barred and cannot be modified. This view is valid, according to the court, for both tax losses and tax credits.

Although these judgments refer to the previous General Taxation Law, it must be recalled that the National Appellate Court, in its judgment of July 21, 2011, discussed in our Newsletter of November 2011, and in a previous judgment of May 26, 2011, stressed that the tax authorities can only examine whether the tax losses exist (and were reported) and were computed correctly in purely "arithmetical" terms.

The Supreme Court has now gone further to say that in these cases penalties do not apply. Firstly, because if an adjustment cannot be made, a penalty cannot be applied either. Secondly, because it is not valid to levy penalties merely for a "failure to pay over" a debt. There must be sufficient evidence that the fault-based requirements for the penalty to apply have been met.

1.2 Corporate income tax.- Thin capitalization, indirect debt and sham arrangement (National Appellate Court. Judgment of December 7, 2011)

A US company (owning the whole capital stock of a Spanish company and a Netherlands company) provided a loan to the Netherlands company which, on the same date, provided a loan in the same amount to the Spanish company. The Netherlands company then transferred to the US company a portion of the debt owed to it by the Spanish company.

The tax inspectors considered that a portion of the interest relating to the debt of the Spanish company was not deductible under the thin capitalization rules. This conclusion was confirmed by the Valencia Regional Economic-Administrative Tribunal and later, by the Central Economic-Administrative Tribunal, which considered (although it had not been suggested by the inspectors) that a sham arrangement had been set up by interposing an EU resident company (the Netherlands company) to avoid thin capitalization rules being applied in a transaction with the US company (because these rules do not apply where the debt is between EU resident entities).

After examining the contents of the inspection work and previous decisions in the economic-administrative jurisdiction, the National Appellate Court upheld the claim filed by the taxpayer, concluding as follows:

- <u>On the application of thin capitalization rules</u>:

  - Thin capitalization rules cannot be applied indiscriminately and automatically, but rather the actual existence of the debt must be determined in each specific case. In this instance, the taxpayer made an effort to argue that there were differences between the two loan agreements (i.e., to provide reasons that they were different legal relationships) although the tax authorities had not contested those arguments in their answer.

  - The nondiscrimination clauses in tax treaties prevail over the thin capitalization rules, as the Supreme Court has already determined in its judgment of March 17, 2011. In this case, the appealed assessments infringed the nondiscrimination principle of Article 26.4 of the Spain-Netherlands tax treaty and Article 25.2 of the Spain-US tax treaty.

- <u>On the existence of a sham arrangement</u>:

  - The sham arrangement cannot be determined in an economic-administrative proceeding, as an economic-administrative tribunal cannot add a new legal ground that had not been established by the inspectors, because:

    - The role of the economic-administrative courts is to make a legal assessment of the decisions submitted to them for review. The addition of a new element, against the claimant, which is not strictly a *reformatio in peius*, is therefore a deviation in exercising reviewing powers.

    - The practice by an economic-administrative tribunal of strengthening the arguments for the decision at issue without having been requested to do so, is not acceptable from a legal standpoint and, moreover, impairs the due process rights of the claimant, who obtains a decision that is removed from the subject-matter on which the discussion arose.

  - Finding a sham arrangement in the loan provided to the Spanish company implies finding that the loan provided by the US company to the Netherlands company was also a sham arrangement, and the Spanish tax authorities have no powers whatsoever to do so; this is aggravated by the fact that this finding was made on an ex parte basis.

- The fact that penalties were not levied by the Regional Economic-Administrative Tribunal, due to the existence of a “reasonable interpretation of the law,” is incompatible with the finding of the existence of a sham arrangement, because of the presence of the intentional element that this entails.

1.3 Corporate income tax.- Deferral relief for reinvestment does not apply to income from transfers of stock options (National Appellate Court. Judgment of December 1, 2011)

In the case under review, stock options were transferred and deferral relief for reinvestment was taken for the income obtained.

The National Appellate Court disallowed this relief on the ground that there had to be a transfer of actual assets (in this case, of the securities that could be bought) and those securities must confer an interest in the capital stock of the entity, which was not the case here (what is transferred is an option on shares, not the shares themselves).

The question to be asked here, however, is whether the tax relief could have been taken by reason of transferring an intangible asset, an issue that was not analyzed by the court or, apparently, raised by the taxpayer.

1.4 Corporate income tax.- Reinvestment tax credit only allowed if transferred assets qualify as fixed assets (National Appellate Court. Two judgments of December 1, 2011)

In order to taken the tax credit for reinvestment of extraordinary income, the transferred assets must have been belonged to tangible fixed assets, intangible assets or real estate investments used in economic activities or certain financial assets.

In various judgments, the National Appellate Court had analyzed the following cases regarding tangible fixed assets:

- The first case concerned the transfer of a building that was acquired to be used in a leasing activity, but had never actually been leased out before it was transferred.

- The second case related to the transfer of the split-off portion of an urban property. The property had always been used in the activity but not the split-off portion after the property had been split.

On the occasion of these two judgments, the National Appellate Court reviewed its past decisions regarding the nature and use of assets which if transferred can trigger income qualifying for the reinvestment tax credit, and highlighted the following aspects, among others:

- Nature of the asset:

    - The fact of an asset being recognized for accounting purposes in one way or another does not change the nature of things, as it is not the accounting treatment that determines how the transaction must be treated (because the accounting records might not correctly reflect the actual circumstances of a transaction).

    - An asset must be classified as a fixed asset or as an inventory by reference to the asset's purpose or use. Moreover, this classification can be changed in the period in which it remains at the entity.

    - An asset's nature does not depend, however, on the shorter or longer amount of time it is held in the entity's assets but rather on its purpose or use in relation to the economic or business activity.

    - Buildings that are built or acquired to be sold belong to current assets and, therefore, do not qualify for the tax credit.

- Use in the activity:

    - Both the former rules on exemption or deferral for reinvestment and the current tax credit system require that the transferred assets must be used in economic activities.

    - The taxpayer's alleged intention to use an asset in an economic activity is not sufficient to be able to take the reinvestment tax credit for the income obtained from transferring it.

    - In order to classify certain assets and fixed assets, it is a must for them to be used in the company's activity on a permanent basis.

    - The burden of proving that the assets belong to the entity's economic activity (i.e., their "use" in the activity) lies with the taxpayer, not the tax authorities.

Based on this interpretation, in the first case, the National Appellate Court disallowed the tax credit because it did not consider it had been proved that the transferred building had been in use in the transferor's business activity. For this purpose, the initial intention to use the building in the leasing activity was deemed not to be valid on its own.

In the second case, the court held that the split transaction did not alter the accounting treatment of the property, because it had been used in the company's activity before it was split (even though, after the split transaction, the split-off portion was recognized for accounting purposes as an asset held for sale). The court therefore allowed the reinvestment tax credit to be taken.

1.5 Corporate income tax.- The tax credit for export activities applies to equity investments if there is a direct link between the investment and the export activity (Supreme Court. Judgments of September 22, 2011 and November 24, 2011)

In the case analyzed, the entity acquired shares in a subsidiary in the same group (equity investment) to which the group already exported. A lower court had ruled against the taxpayer, as it considered that the tax credit for export activities could not be allowed for equity investments because they are not strictly an export of goods and services and so would be contrary to the aim of this tax benefit.

By contrast, the Supreme Court considered that cases such as acquisitions of shares within a group in order to carry out a reorganization do not prevent a direct link existing between the investment and the export activity. The court therefore held that where there is a causal relationship between the equity investment and the export activity, there is nothing to prevent the tax credit from being taken.

Nonetheless, we cannot fail to mention the particular vote issued by a number of judges from the Chamber in the judgment dated September 22, 2011, which stated that, according to the wording of the provision governing the tax credit at issue, it can only apply to equity investments if certain requirements are met, which are minimum conditions that apply restrictively:

- The investment must actually be made in the tangible fixed assets or intangible assets of branches or permanent establishments or in financial investments, by acquiring shares in foreign companies or creating subsidiaries with a minimum ownership of 25% of the subsidiary’s capital. These requirements are mandatory as they are established in the law itself.

- There must be export activity on a long-term basis, to achieve the aim of the tax credit.

- There must be a causal relationship between the investment made and the export activity.

In the case analyzed in the judgment, the investment was made in an acquisition of shares carried out, according to the judgment by the lower court and the particular vote, not to encourage exports but rather in the context of the reorganization of the same business group, since both before and after the acquisition of shares, control remained at the same company with decision-making capacity on the volume of exports. The court therefore held that if the exports had increased, the reason for that occurring could not be an acquisition which does not alter the underlying economic interests or the ultimate power to manage the business which was held by the same entity, the parent, at all times.

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1.6 Personal income tax.- Stock options: The regulatory requirement that stock options cannot be awarded annually in order to benefit from treatment as *multiyear* income is unlawful (Supreme Court. Judgment of November 16, 2011)

The Personal Income Tax Law determines that any salary income generated over more than two years, which is not periodical or recurring, is *multiyear* income. Some years ago, it was established in the regulations that these conditions were deemed met in the case of stock options if they could only be exercised after a period of more than two years and also on condition that they were not awarded annually. These requirements were set out in Royal Decree 214/1999, Royal Decree 1775/2004 and Royal Decree 439/2007—currently in force—in their original wording.

These two requirements (that the stock options must not be awarded annually and must be exercised after two years have elapsed) were held to be unlawful and rendered null and void by the Supreme Court (in judgments of July 9, 2008 and April 30, 2009). The first, because it was ultra vires the regulations; the second, mainly because the treatment of an item of revenue cannot depend on the chance of obtaining it but rather must depend on its actually being obtained. The rendering null and void of this second requirement led to an amendment of the wording of the regulation currently in force, to the effect that the options are multiyear if they are actually exercised after more than two years have elapsed.

The Supreme Court held, with respect to Royal Decree 214/1999, that the first requirement (options not awarded annually) was unlawful. Sustainable Economy Law 2/2011 amended the Personal Income Tax Law, by establishing the following requirements in order for income to be deemed multiyear: (i) the stock options must not be awarded annually, and (ii) the options must be exercised after two years have elapsed.

This amendment to the law applies retroactively to the income recorded in a tax period ending after August 4, 2004. This is precisely the date on which Royal Decree 1775/2004 took effect (only Royal Decree 214/1999 had been held to be unlawful by the Supreme Court).

The Supreme Court has now ruled, in a judgment dated November 16, 2011, that the article of the Regulations currently in force (Royal Decree 439/2007) is unlawful because it is substantially identical to that of Royal Decree 214/1999 which was rendered void by the judgment dated April 30, 2009.

Now that the article of the current Regulations (in the part establishing that the options could not be awarded annually) has been held unlawful, doubts have arisen as to the validity of the retroactivity clause under Law 2/2011.

1.7 Value added tax.- Strict joint and several liability system, apportioning liability without negligence or fault, is contrary to the proportionality principle (European Court of Justice. Judgment of December 21, 2011 on Case C-499/10)

The EU Sixth Directive allows Member States, in certain scenarios, to hold a person other than the person liable for the VAT to be jointly and severally liable for payment. Belgian VAT law, in particular, provides that under warehousing arrangements other than customs warehousing, the warehouse-keeper, the person responsible for the transport of the goods from the warehouse and, where applicable, his principal are jointly and severally liable towards the State for the payment of the tax together with the persons who are liable for the tax.

The European Court of Justice examined a question referred for a preliminary ruling regarding the lawfulness of that Belgian provision as it establishes a system of strict joint and several liability for warehouse-keepers other than customs warehouse-keepers for the payment of the VAT owed by the warehouse user. In the case under examination, the Belgian government claimed from the warehouse-keeper (pursuant to that legislation) the payment of the VAT on supplies of goods for consideration made from the warehouse, after unsuccessfully attempting to collect the tax from the warehouse user who had been declared insolvent.

The court ruled that national provisions that determine a system of strict joint and several liability, without the person held liable being able to provide proof that he acted within the law, infringe European Union law, as they are contrary to the principle of proportionality. The court clarified, however, that it is not contrary to European Union law to require the person other than the person liable to pay the tax to take every step reasonably necessary to satisfy himself that the *transaction which he is effecting does not result in his participation in tax evasion*.

1.8 Tax on erection and installation projects and construction work ("ICIO").- In photovoltaic facilities, the taxable amount is the cost of all elements included in the facilities (Supreme Court. Judgment of November 23, 2011. Official State Gazette of December 20, 2011)

In a judgment dated May 14, 2010, the Supreme Court held that the taxable amount for the tax on erection and installation projects and construction work ("ICIO") in the case of wind farms was the sum of the costs of all the elements needed to harness energy as specified in the plans for the project for which the building permit was requested and which do not have individual features or their own identity with respect to the structure carried out.

In this new judgment, the Supreme Court took the same view in relation to the facilities of photovoltaic plants, by holding that the taxable amount for ICIO purposes in these cases takes in not only the construction work required to build the plant (civil work) but also all of the elements that are included in the plant and are needed to convert solar energy into electricity.

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1.9 ICIO.- Autonomous community law providing for exemption from local tax contrary to principle of matters reserved for legislation by statute only (Constitutional Court. Judgment of November 23, 2011)

The Catalan Cultural Heritage Law contains an exemption from ICIO for construction work performed to conserve, improve or renovate monuments declared to be of national interest.

In this judgment, the Constitutional Court examined the constitutionality of an autonomous community law providing for an exemption from a local tax, such as the ICIO, which is subject to central government legislation. The question was referred after the local authority in question denied the exemption on the ground that the law allowing the exemption was unconstitutional.

The Constitutional Court held that:

- Any exemption is a basic component of a tax, and the provision of exemptions is subject to the principle of matters reserved for legislation by statute only.

- In this case, as ICIO is a central government tax, the exemption can only be established by central government lawmakers.

Therefore, the provision of an exemption by autonomous community law does not observe the principle of matters reserved for legislation by statute only and, therefore, that law is unconstitutional in that respect. The court held, however, that any tax and legal status afforded by that provision cannot be reviewed as a result of the ruling of unconstitutionality.

1.10 Review proceeding.- The late notification of the filing of a claim for judicial review with petition to maintain a stay is not sufficient reason to enforce the administrative decision (National Appellate Court. Judgment of October 27, 2011)

When a claim for judicial review is filed, a stay ordered in the administrative jurisdiction can be maintained, although the tax collection authorities must be notified, within the period for filing the claim for judicial review (two months, generally) that this claim has been filed and that the stay has been requested.

In the case under consideration, the filed claim had been notified but only after the two-month period had elapsed, and the tax authorities enforced the debt.

The National Appellate Court held that the purpose of stays is to avoid hasty enforcements by the tax authorities, so it makes no sense for the period for notification to the tax collection bodies to be considered peremptory. Furthermore, the prudence associated with the principles of good faith and of complete prevalence of judicial control requires the tax authorities to suspend all actions for enforcement in a case where, before that enforcement, the tax authorities were already aware of the filing of the claim (even if it had been notified late).

1.11 Judicial review proceeding.- In tax audits, authorities must analyze and refute expert opinions provided by taxpayer (National Appellate Court. Judgment of May 30, 2011)

The inspectors had queried a R&D tax credit taken by a company on the ground that the company had invested in projects that did not really qualify for the tax credit because they were not sufficiently innovative. The company provided to the Catalan Regional Economic-Administrative Tribunal an opinion on the true nature of the activities, issued by a professor with a doctorate qualification, specializing in management of innovation and technology in the specific subject at issue. The court found in favor of the company primarily because the tax authorities had not provided the objective and reasonable proof required to refute the expert opinion submitted. The following conclusions may be inferred from this judgment:

- To clarify in certain cases the question of whether this tax credit can be taken, basic technical knowledge is necessary, which requires the assistance of experts with sufficient qualifications and knowledge in that area, and a mere superficial examination by people who are not experts in the subject-matter is not valid for this purpose. Therefore, both the taxpayer and the tax authorities must rely on expert evidence with guarantees of impartiality and technically and professionally sound judgment provided by technical experts.

- Innovation in the products, materials o processes to which the law refers must be interpreted in the context of companies that are not necessarily engaged in scientific or technical research or development, but rather of business companies for which those research and development activities are a means to improve productivity.

Lastly, the National Appellate Court recalled that in any phase of the procedure, both in the administrative phase and in the judicial phase, the tax authorities must give consideration to the technical evidence and opinions or reports submitted by the taxpayer, which obviously can be contrasted and refuted, but that procedural step necessarily implies that the tax authorities must give an opinion on them, for which it must also rely on qualified and specialized opinions in the relevant fields of technical or scientific knowledge.

1.12 Collection proceeding.- Attachment of assets under a community property arrangement when the tax debt fell due (National Appellate Court. Judgment of October 10, 2011)

The court examined a case of attachment of some assets that had been awarded to one of the spouses in the liquidation of a community property arrangement, as a result of the tax debts incurred by the company at which the other spouse who had been held secondarily liable for the payment of those debts was director. The debts had fallen due before the liquidation of the community property arrangement.

The National Appellate Court agreed with the decision of the Central Economic-Administrative Tribunal and held that proof had been provided that the tax debts were incurred in conducting a commercial activity on a community property basis and that they had fallen due before the dissolution of the community property arrangement, meaning that they were liable against the assets forming part of that community property arrangement, a liability that does not disappear merely because some of those assets were later awarded to the nondebtor spouse.

This liability (against the assets of the nondebtor spouse) occurs as a result of the substitution of the assets that should have been used to settle the debts when they fell due, because they belonged in an equal share to the person with secondary liability but as a result of steps taken after the debts fell due, the plaintiff had acquired exclusive ownership.

1.13 Management procedures– pricing review. (Supreme Court judgments of December 12 and December 7, 2011)

The Supreme Court has again stressed the need for detailed reasoning by the tax authorities for pricing reviews (in its judgment of December 12, 2007). These reviews are not justified when the tax authorities do not go beyond using stereotyped methods. The tax authorities must give specific reasons for the price, the special pricing methods used, and the basis for judgment taken into account to reach the reviewed price determining the taxable amount for the tax concerned.

Nonetheless, in a judgment dated December 7, 2011, the Supreme Court appears to reach a contrary conclusion when, in reference to a pricing review by the tax authorities based on the appraisal of a building for mortgage purposes, it holds as a legal precedent that "*the use by the tax authorities of the pricing review methods under Article 57.1.g) of the General Taxation Law ("Value assigned for the appraisal of mortgaged properties pursuant to mortgage legislation"), in the wording given by Law 36/2006, of November 29, 2006, does not require any additional burden for the tax authorities with respect to the other pricing review methods, and therefore they are not required to justify in advance that the value used for the appraisal of mortgaged properties coincides with the price adjusted to the taxable amount for the tax, or the existence of any element of evasion that must be adjusted*".

In the case analyzed, the taxpayer had requested a pricing for tax purposes from the competent authorities for transfer tax purposes, which was the pricing ultimately used to report that tax, but the tax assessment office carried out a pricing review and when it determined that the value derived from the mortgage appraisal was higher, it applied that higher price, without providing any justification or refuting the first pricing. As we can see, however, the Supreme Court has confirmed the validity of the authorities' practice because they used one of the methods established in the General Taxation Law as a valid method to be used by the tax authorities to review the pricing of assets.

2. DECISIONS AND RULINGS

2.1 Corporate income tax.- Tax credit for reinvestment of capital gains generated on transactions with deferred payment (Directorate-General of Taxes. Ruling V2802-11, of November 25, 2011)

Shares were transferred with deferred payments over five years (without explicit interest) and, under accounting rules, the transferor recognized a financial asset using the amortized cost method. That method entailed breaking down the amount received for the sale into two parts: the principal of the transaction and the implicit interest.

The requested ruling was on how to calculate the related tax credit for reinvestment of extraordinary income, on which the Directorate-General of Taxes "(DGT") concluded as follows:

- The income derived from the transfer must be determined by reference to the fair value of the debt at the time of the sale or, in other words, the present value of the stipulated price of the transaction in which payment has been deferred over five years, calculated according to the effective interest rate that will apply to the fair value of the shares at the time of the transfer. This is the amount that must be reinvested (i.e., not the price but the price less implicit interest).

- The tax credit base (the capital gain) is the difference between that price discounted to net present value and the book value of the shares, regardless of whether the market interest rate may vary at a later date with respect to the effective interest rate on the transaction, since any such variation will not affect the value of the debt recognized as a result of the transfer performed.

- In short, the income relating to the interest accrued in each year, according to the effective interest rate on the transaction, will not in any case form part of the tax credit base, even if that interest must be reflected in the statement of income, forming part of the tax base.

2.2 Corporate income tax.- Reinclusion of subsidiary in tax group due to resolved equity deficiency (Directorate-General of Taxes. Ruling V2657-11, of November 7, 2011)

Under the corporate income tax legislation, any companies involved in insolvency proceedings or subject to one of the grounds for mandatory dissolution at their fiscal year-end cannot belong to a tax group, unless they resolve those circumstances before the end of the fiscal year in which the financial statements are approved.

The company's departure from the group, in these cases, takes effect from the first of the fiscal years (that of the year-end) and not in the second (the year in which financial statements are approved). If, once outside the group (because its circumstances were not

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resolved in the following year), the company's equity deficiency is subsequently resolved (in a certain fiscal year "n"), the DGT considers that the company's reinclusion in the tax group must take effect in the previous year (in fiscal year "n-1").

In other words, if a subsidiary is involved in an insolvency proceeding or subject to one of the grounds for mandatory dissolution, for example, at the end of 2011, it will leave in the fiscal year starting in 2011, if those circumstances are not remedied in 2012. If they are remedied in 2013, the subsidiary will rejoin the consolidated tax group starting in and including 2012. In this case, that company will only have been excluded from the tax group in 2011.

2.3 Corporate income tax.- The licensing of intangibles to the company that created them does not give entitlement to the reduction for revenues under Article 23 (Directorate-General of Taxes. Ruling V2644-11, of November 7, 2011)

In this case, a company, creating certain intangibles, transferred the material and human resources belonging to its R&D&i activity and the patents developed up to the date of the transfer, to a newly created entity.

The DGT recalled in this ruling that if the transfer is carried out under the special tax neutrality rules, the transferee can take the reduction for the licensing of intangibles. For these purposes, it will not be necessary for the intangible assets to have been recognized in the assets of the balance sheet of the creator company if, under accounting rules, they could be recognized as period expenses.

The DGT noted, however, that the reduction cannot be applied by the transferee for the licensing of intangibles to the transferor that created them.

2.4 Corporate income tax.- Impairment losses in respect of claims in insolvency proceedings on related entities will not be deductible until the court opens the liquidation phase (Directorate-General of Taxes. Ruling V2643-11, of November 7, 2011)

Impairment losses in respect of claims from related persons or entities are not deductible except in case of "insolvency determined by a court." This ruling analyzed whether the insolvency order meets this requirement. The DGT's reply was that it does not, on the following grounds:

- The "insolvency determined by a court" (which is not a legally defined concept) must be associated with definitive, not temporary, insolvency.

- An insolvency order on a company merely states that the debtor is insolvent, without specifying whether it is temporary (in what used to be a standstill arrangement) or definitive (formerly a bankruptcy order).

- Only when there has been a court order opening the liquidation phase (either in the initial phase of the insolvency or as a consequence of the breach of an arrangement with creditors) can it be assumed that the insolvency has been determined by a court, since it is only when the liquidation phase is opened that it can be assumed that the debtor is not going to continue with its activity or be able to settle all of its liabilities.

2.5 Corporate income tax.- Special tax neutrality rules: transfer of a real estate leasing line of business by an individual (Directorate-General of Taxes. Ruling V2619-11, of November 3, 2011)

This ruling examined the case of an individual, a business owner, whose business consists of leasing factory buildings, for which he has a set of premises used exclusively to manage the leasing activity, and an employee hired under a full-time employment contract and registered under the standard social security system for those management activities (his daughter was that employee for a certain amount of time).

The real estate assets used in the activity are (i) several factory buildings leased to an unrelated party, (ii) several sets of premises leased to group companies, (iii) factory buildings acquired with the intention to be leased out, and (iv) plots of land recognized in for accounting purposes as inventory on which construction work will be carried out and which will be leased out or sold.

The ruling request was in relation to transferring this line of business to an entity engaged in property development and leasing, and it was asked whether this transfer could be carried out under the tax neutrality rules. The ruling was as follows:

- Importantly, the DGT did not question the fulfillment of the "employee and premises" requirement set out in personal income tax legislation for the real estate lease to be deemed a business activity, even though the employee was the requesting party's daughter. It must be recalled here that under the Workers' Statute, it is presumed that descendants who live with the business owner do not have an employee relationship with him.

- With regard to the inclusion of those real estate assets in the line of business, the DGT ruled that besides the property leased out (to related or unrelated parties), the real estate offered for lease since it was acquired can be deemed to be included, even if no lease agreement has been perfected, on condition that the business owner has made all possible efforts and taken all possible steps to be able to lease out the property (published adverts, hired real estate agencies, taken steps itself, etc.) and that those steps can be evidenced.

  On the other hand, the plots recognized as inventories on which construction work has yet to be carried out and which have yet to be leased out or sold, are not part of the line of business because, based on the facts set forth in the ruling request, the economic activity performed by the individual does not appear to include the development of real estate to be leased or sold.

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2.6 Personal income tax.- Travel allowances: computation of the nine-month period (Directorate-General of Taxes. Ruling V2608-11, of November 2, 2011)

Personal income tax legislation provides an exemption for meal allowances not exceeding certain daily amounts where the worker travels to a town or city other than his place of work and residence. That exemption does not apply, however, if the trip lasts longer than nine consecutive months. In relation to this time limit, the DGT has clarified two issues:

- The nine-month period is computed from date to date, meaning that the period is not interrupted on December 31 of each year.

- The nine-month period only applies in relation to the same town or city, so if the employee travels to more than one town or city, the nine-month period is computed separately for each of them.

2.7 Value added tax.- In related-party transactions carried out before December 9, 2006, the VAT taxable amount is the agreed consideration. (Central Economic-Administrative Tribunal. Decision of November 25, 2011)

Article 79.5 of the VAT Law in force prior to December 9, 2006, determined that when the prices established in related-party transactions are notably lower than market prices, the taxable amount could not be lower than the prices that would have resulted from applying the rules for determining the taxable amount in self-supplies of goods and services.

In the case under examination, which involved a supply of real estate as a result of a spin-off, basing themselves on that provision, the tax inspectors determined the taxable amount of the supply by reference to the market value of the assets.

By contrast, the Central Economic-Administrative Tribunal (“TEAC”), referring to the determinations by the European Court of Justice in its judgment of June 9, 2011 on case C-285/10, held that the Sixth Directive does not allow a Member State to establish that the taxable amount in a transaction between related parties can differ from the agreed consideration (unless the Member State has requested authorization under the procedure in Article 27 of the Directive). As Spain had not requested that authorization, the market price rule mentioned above could not be applied.

In view of the changes in Spanish and EU legislation, the inspectors’ conclusion can only apply to supplies of goods and services made before December 9, 2006. After that date, the special rule contained in Article 79.5 of the VAT Law in the wording established by Law 36/2006 applies, which also refers to the market price but restricts it to cases in which the use of a different price entails, on a very general basis, (i) altering the deductible proportion to the benefit of the trader that makes the supply or (ii) reducing the nondeductible VAT borne to the benefit of the transferee.

2.8 Transfer and stamp tax.- Property subject to finance lease is not computed as real estate for the purpose of Article 108 of the Securities Market Law until purchase option is exercised (Directorate-General of Taxes. Ruling V2735-11, of November 17, 2011)

According to Article 108 of the Securities Market Law (LMV), transfer tax applies to certain transactions to acquire the control of companies whose assets consist primarily of real estate.

This ruling analyzed whether Article 108 LMV applies when a company's assets consist primarily of real estate that is being financed under finance lease agreements. The DGT held that given that the transfer of ownership of that real estate to the company would only take place when the purchase option is exercised, Article 108 does not apply (irrespective of how those assets must be recognized for accounting purposes during the term of the finance lease)

2.9 Collection proceeding.- When a supplementary tax return results in a refund below that requested in the original tax return, late payment interest applies rather than surcharges for late filing (TEAC. Decision of November 28, 2011)

The taxpayer filed a supplementary return in which the amount of tax to be refunded was lower than the amount requested in the original return. Because the tax refund originally requested had already been paid, the supplementary return resulted in an amount payable by the taxpayer. The tax authorities levied a surcharge for late filing on the claimant, amounting to 5% in this case because less than 3 months had run since the end of the voluntary filing period.

Contrary to this view, the TEAC considered that surcharges for late filing were not applicable in these cases because:

- Both the original self-assessment return and the supplementary return resulted in a refund (albeit lower in the supplementary return).

- As the tax return did not result in an amount payable, the rules on surcharges for late filing did not apply, but rather late-payment interest applied because a refund had been incorrectly collected.

This view confirms that contained in previous decisions by the TEAC, such as the decision dated February 10, 2009.

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3. LEGISLATION

3.1 Spain-Singapore tax treaty

The Spain-Singapore tax treaty, signed in Singapore on April 11, 2011, was published in the Official State Gazette on January 11, 2012.

The key points of this tax treaty are the following:

- The tax rates applicable according to the type of income obtained are the following:

  - Dividends: they are exempt if the beneficial owner is a company (other than a partnership) which owns directly at least 10% of the capital of the company paying the dividends; in all other cases, the maximum tax rate will be 5% of the gross amount of the dividends.

    In the specific case of distributions made out of a listed real estate investment trust, the taxation will be 5% of the gross amount distributed if the beneficial owner directly or indirectly owns less than 10% of the value of the capital contributed to that entity. This, however, will not affect the taxation of the profits of the company or the real estate investment trust out of which those dividends are paid or the distributions are made.

  - Interest: 5% of the gross amount of the interest. In some special cases, however, the interest will only be taxed in the country of residence.

  - Royalties: 5 % of the gross amount of royalties.

  The provisions on dividends, interest and royalties do not apply, however, if it was the main purpose of any person concerned with the creation or assignment of shares or other rights in respect of which the dividends are paid, the creation or assignment of the debt-claim in respect of which the interest is paid, the creation or assignment of rights in respect of which the royalties are paid, to take advantage of the benefits of the tax treaty by means of that creation or assignment

- Capital gains will be taxable in the country of source where they derive from (i) the alienation of immovable property, (ii) the alienation of movable property of a permanent establishment, (iii) the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the other Contracting State (with certain exceptions), and (iv) the alienation of shares which directly or indirectly entitle the owner of such shares to the enjoyment of immovable property situated in that State

This tax treaty will enter into force on February 2, 2012 and its provisions will take effect:

- in respect of tax withheld at the source on amounts paid or credited to nonresidents, on or after January 1, 2013.
- in respect of other taxes, for taxation years beginning on or after January 1, 2013.
- in all other cases, on or after January 1, 2013.

Lastly, starting on the date of its entry into force, Singapore will no longer be classed as a tax haven.

3.2 Brief summary of the measures introduced by Royal Decree-Law 20/2011, of December 30, 2011 (Official State Gazette of December 31, 2011)

In our New Legislation Bulletin 1-2012, we analyzed the tax, corporate and labor reforms introduced by this Royal Decree-Law. As a reminder, the main provisions are summarized below:

- Personal income tax has been increased for fiscal years 2012 and 2013, through the introduction of a surtax on the tax payable to the central government, which raises the tax rates on the general net taxable income by between 0.75% and 7%. That brings the maximum marginal rate up to 52% (applicable to net taxable income over €300,000), subject to the provisions established by each autonomous community.
- The personal income tax rates applicable to taxable savings income have also been increased by between 2% and 6%, and that income will now be taxed at between 21% and 27%.
- The rates for personal income tax, corporate income tax and nonresident income tax withholdings have also gone up.
- The withholding rates applicable to salary income have gone up along the same lines as the standard rate for net taxable income (i.e., with an increase of between 0.75% and 7%); the fixed withholdings rates on account of the three taxes which were 19%, have been raised to 21%; the fixed withholding rate applicable to directors and board members has gone up from 35% to 42% and, lastly, the standard 24% nonresident income tax rate has risen to 24.75%.
- The personal income tax credit for investment in the taxpayer’s principal residence has been reinstated subject to pre-2011 rules (after which the tax credit was limited to certain taxpayers according to their income), effective starting in 2011.
- There has been an extension to the periods commencing in 2012 of the provision establishing that the costs and investments to encourage employees to use new communications and information technologies, where they can only be used outside their place and hours of work, will not be treated as compensation in kind and will allow the corporate income tax credit for training activities to be taken.

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- The new Royal Decree-Law also extends to periods commencing in 2012 (i) the 20% personal income tax reduction in net income from economic activities for maintaining or creating employment; and (ii) the application of the super-reduced 20% corporate income tax rate for entities which have net revenues lower than €5 million in the period, have an average headcount in the period lower than 25 employees, and create or maintain employment.

- The percentages used to calculate split payments on account of corporate income tax (for companies using the method based on taxable income in the period comprising the first 3, 9 or 11 months) have remained at the rates approved in August 2011, that is, between 21% and 27% according to net revenues.

- The super-reduced 4% VAT rate for supplies of buildings or parts of buildings suitable to be used as dwellings, including parking spaces, with a maximum of two units, and annexes located within them which are transferred jointly, has been extended to 2012.

- The real estate tax rates applicable in 2012 and 2013 have been raised; the increases basically depend on the year in which the last set of official assessable values were approved for the municipality in question where the taxable building is located.

3.3 Electronic notices: "courtesy days"

As we mentioned in our November newsletter, Royal Decree 1615/2011, of November 14, 2011, amended Royal Decree 1363/2010, of October 29, 2010, regulating the cases of mandatory administrative notices and communications by electronic means in areas concerning the State Tax Agency, to expressly establish the possibility for taxpayers to specify a maximum of 30 days every calendar year in which the State Tax Agency cannot send notices to them at their designated e-mail ("courtesy days").

That Royal Decree was implemented by Order EHA/3552/2011, of December 19, 2011 (Official State Gazette of December 29, 2011), which establishes as follows:

- Taxpayers may specify a maximum of 30 days per calendar year, freely chosen by them and without needing to group together a minimum number of days.

- The request must be made at least 7 calendar days before the first day on which it will take effect, and once those "courtesy days" have been specified, they can be modified by express request, which will make the initially chosen period invalid, with the same restrictions regarding the maximum number of days per year per taxpayer and the minimum advance notice.

- Taxpayers who are mandatorily included in the system or who voluntarily register to receive notices by e-mail in certain proceedings during the year can benefit from all 30 days in the calendar year in progress, without needing to distribute the days on a pro rata basis over the remaining days in that year.

- The specification of days will only affect any notices that might have been made in the days specified and may not in any case be deducted from the computation of periods that have already commenced because the notification has been made before the first day specified.

- The courtesy days must be specified obligatorily at the website of the State Tax Agency (www.agenciatributaria.gob.es.)

This Order took effect on December 30, 2011, although the specification of the days on which the State Tax Agency cannot make notifications to taxpayers through their authorized e-mail addresses did not take effect until January 1, 2012.

3.4 Levy for the exercise of the power to seek judicial redress in the civil and judicial review jurisdictions: new form 696

As a consequence of the amendments made by Law 37/2011, of October 10, 2011, on Measures to Expedite Proceedings (which reduced to €50 the fixed amount used to determine the amount of the charge), a new tax return has been approved (through Order EHA/3552/2011, of December 19, 2001, published in the Official State Gazette of December 29, 2011) for the levy for the exercise of the power to seek judicial redress in civil and judicial review jurisdictions in order for payment procedures.

3.5 Average sale prices for fiscal year 2012 of certain means of transport, for purposes of pricing reviews

As happens every year, the government approved the Order (Order EHA/3551/2011, of December 13, 2011, published in the Official State Gazette on December 29, 2011) approving the average sale prices applicable in the management of transfer and stamp duty, inheritance and gift tax and special tax on certain means of transport, which maintains the table of rates approved in the Order for 1998, because it continues to reflect the actual circumstances of the vehicles market and the depreciation of automobiles.

3.6 Attachment of funds in accounts at credit institutions

The Decision dated November 16, 2011, approving the procedure for the electronic attachment of funds in current accounts open at credit institutions, was published in the Official State Gazette of December 27, 2011.

According to that procedure, actions for attachment by the collection authorities of the State Tax Agency in relation to demand deposits at credit institutions will be done online rather than in situ, regardless of the amount to be attached.

There are certain cases, however, (demand deposits at credit institutions where some or all of their balances have been pledged and those belonging to debtors subject to an insolvency order) in which, due to the legal circumstances of the account or of the debtor, the attachment procedure cannot be completed electronically.

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In order to regulate attachment procedures in those other cases, another decision was approved, also dated November 16, 2011, but published in the Official State Gazette on December 28, 2011, establishing that the attachment in such cases will be done on a centralized basis on the Internet.

These decisions will apply to procedures for the attachment of demand deposits initiated by the State Tax Agency on or after June 1, 2012.

4. OTHER NEWS

4.1 New Directive on parent companies and subsidiaries of different Member States

The European Council has approved Council Directive 2011/96/EU, of November 30, 2011, on the common tax regime applicable to parent companies and subsidiaries of different Member States (recast), effective starting on January 18, 2012, abolishing the directive in force up to now (Council Directive 90/435/EEC, of July 23, 1990).

This Directive is a recasting of the different legislative provisions in the area of EU law that have been adding amendments to the initial wording over the past years.

The Member States were required to enact the statutory, regulatory and administrative provisions necessary to fulfill the provisions in this Directive by January 18, 2012 at the latest.

4.2 Plan to combat tax fraud

The Council of Ministers held on January 5, 2012 analyzed the general guidelines that will form the basis of the General Tax Control Plan for 2012. It also studied various measures that will be implemented throughout the year in order to clamp down on tax evasion.

The guidelines that will form the basis of the General Tax Control Plan for 2012 are structured in the following sections:

- Audit and investigation of tax fraud: This section includes the actions to be taken in the sectors or economic activities where there is a greater perception of fraud, and actions relating to international taxation, investigation of the black economy and control of foreign trade and special and excise taxes.

- Fraud control in the collection phase: The guidelines establish that the intervention of the collection bodies should be brought forward to when tax management proceedings begin, and encourage the adoption of injunctive remedies and procedures for enforcing secondary liability. They also promote the use of available antiabuse provisions, such as liability for concealment of assets and lifting of the corporate veil, and, for more serious cases, accusation of criminal insolvency.

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- Collaboration of the autonomous community tax authorities: In the prevention of fraud in relation to taxes that have been devolved to the autonomous communities regarding their collection and management, the guidelines promote the adoption of information exchange agreements between the tax authorities of the autonomous communities and of the central government. In 2012, progress will also be made in establishing permanent channels for the exchange of tax information between the central government and the provincial tax authorities for the Basque Country and Navarre.

Moreover, the government has studied various measures and considered legislative amendments or adaptations to be implemented throughout 2012. They include measures aimed at encouraging voluntary compliance and the prevention of fraud through (i) voluntary disclosure, (ii) self-correction of census errors, (iii) extension of the scope of the personal income tax draft return, or (iv) promoting the use of online tax procedures.

Also in the context of the fight against tax fraud, the government will study the possibility of placing a limit of some kind on the use of cash in certain economic transactions.

In the international arena, Spain is going to sign new information exchange agreements and include information exchange clauses in its tax treaties.

Lastly, with the aim of consolidating a system for reacting against fraud in tax collection, the government will study a change in the legislation in force to introduce improvements in the claiming of tax liabilities, in the adoption of injunctive measures and in the penalty system.

4.3 Cross-border relief for inheritance taxes in the European Union

In order to establish the manner in which the Member States can apply measures or improve existing measures to relieve double or multiple taxation caused by the application of inheritance taxes by two or more Member States, the European Commission has adopted Commission Recommendation 2011/856/EU, dated December 15 2011, regarding relief for double taxation of inheritances.

According to that Recommendation, the Member States are asked to introduce certain forms of tax relief (i) in respect of immovable property and movable property of a permanent establishment, (ii) in cases where the deceased had a personal link to a Member Sate other than that to which the heir has a personal link, or (iii) in cases of multiple personal links of a single person, among others.

Moreover, the Members States are encouraged to operate a mutual agreement procedure to deal with any disputes connected with double taxation.

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4.4 Survey on the functioning of the Spanish tax system

The Fundación Impuestos y Competitividad (Tax and Competitiveness Foundation), formed in October 2011, is making an anonymous and confidential survey to obtain the opinion of Spanish companies, particularly large enterprises, on the Spanish tax system and its application. The Foundation has engaged Universidad Pontificia de Comillas to perform the survey.

The objective of the project is to gain in-depth knowledge of our tax system in order to identify the aspects that need to be reformed.

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