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The reform of the regime for monetization of deferred tax assets in the General Budget Law for 2016

1. Introduction

Royal Decree-Law 14/2013 introduced into corporate income tax law a regime for the conversion of deferred tax assets ("**DTAs**"). The regime consisted of a new timing of recognition rule in the tax base for certain provisions for the impairment of receivables or other assets in respect of bad debts and provisions or contributions to employee benefit systems and, where applicable, to preretirement systems. It also set out the requirements and options for carrying out the conversion of the DTAs in respect of those provisions into a sum claimable from the tax authorities (i.e. the monetization of DTAs).

The preamble to Royal Decree-Law 14/2013 specified the main reason for the reform made at that time, which was to allow certain DTAs to be able to continue to be computed as capital, in line with the rules in force in the European Union, so that Spanish credit institutions could operate in a uniform competitive environment. The reference to European legislation relates to Regulation (EU) No 575/2013 of the European Parliament and of the Council, of June 26, 2013, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 ("CRD IV").

Now, the General Budget Law for 2016, effective for tax periods beginning on or after January 1, 2016, amends the regime to make the conversion a right for the taxpayer, lay down new conditions for being eligible for the conversion and add certain disclosure obligations in relation to the DTAs affected by the legislation. It also introduces a transitional regime applicable to the DTAs generated before January 1, 2016, according to which, if certain conditions are not satisfied, the right to the conversion may be retained although a public levy must be paid to be allowed to do so. In the reasoning for the amendment by the Parliamentary Group in the upper house of the Spanish parliament which introduced this reform in the parliamentary process for the Budget Law, it was explained that the purpose of the public levy was "*to compensate for the risk that is transferred to the State*" as a result of the monetization of DTAs, "*although this activity does not fall within the definition of a charge, because it does not qualify as a public service or activity, but within the category of other types of services or activities performed by the government, and therefore, in short, a public levy as defined in article 31 of the Spanish Constitution must be put in place*".

The wording of the reform poses a number of important questions that need to be clarified. Described below are a few of the most prominent.

2. Amendment of the regime for the monetization of DTAs

2.1 Amendment of article 11.12 of the Corporate Income Tax Law (LIS): timing of recognition rule

The new subarticle 19.13 included in the former Revised Corporate Income Tax Law laid down a new timing of recognition rule, under which certain timing differences that had generated DTAs were not converted into tax assets in respect of tax losses. The particular provisions to which this rule relates include (i) provisions for the impairment of receivables or other assets resulting from bad debts due by debtors not related to the taxpayer, not owed by public law entities and which have not become deductible because a six month period has elapsed from the maturity of the obligation (therefore, it affects the provisions in Annex IX to Bank of Spain Circular 4/2004), and (ii) the provisions or contributions to employee benefit systems and, if applicable, preretirement systems.

The new Corporate Income Tax Law, Law 27/2014 ("**LIS**") introduced an additional limit on the inclusion of these provisions in the tax base, following satisfaction of the requirements for their deduction: the amount that may be included is restricted to 70% of the positive tax base before its inclusion, before the use of the capitalization reserve and before the offset of tax losses (60%, in 2016 and 25%/50% in the tax periods beginning in 2015 similarly to the limit on the use of tax losses).

Following the reform of the General State Budget Law, in the tax periods beginning on or after January 1, 2016, it appears that these timing of recognition limits will only be applicable to the provisions that have given rise to DTAs eligible for conversion into a sum claimable from the tax authorities according to the reform of article 130 LIS ("**monetizable DTAs**").

Conversely, this new wording appears to allow any DTAs not satisfying the requirements in article 130 LIS for their conversion ("**non-monetizable DTAs**") to be included in the tax base with no limit, and the timing of recognition rule in article 11.12 LIS will not apply to them.

The existing FIFO rule has been retained, under which the DTAs that have not been included in one tax period will be included in the following tax periods within the same limit, starting with the earliest provisions. Additionally, it establishes an order for including them in the tax base where both monetizable and non-monetizable DTAs are generated in the same tax period (because article 130 is only partly applicable), laying down that the provisions related to the non-monetizable DTAs must be included first.

The legislation appears to determine that the provisions will continue to be included on a FIFO basis (i.e. earlier provisions first) and it is when applying that FIFO rule that the new order will come into play (the non-monetizable DTAs must be included first if both monetizable and non-monetizable DTAs are generated in a given period).

Lastly, it must be noted that no amendments are made to the timing of recognition rules laid down, in relation to article 11.12 LIS, for taxpayers under the consolidated tax group regime.

2.2 Amendment of article 130 LIS and transitional regime: monetization of DTAs

As was to be expected from the reasoning for the amendment, the title and the wording of article 130 are amended to underline that the monetization is an optional right for the taxpayer.

2.2.1 DTAs generated in tax periods beginning on or after January 1, 2016

In the tax periods beginning on or after January 1, 2016, the DTAs in respect of the qualifying provisions may be converted into a sum claimable from the tax authorities in an amount equal to the net tax payable for the tax period in which they were generated, insofar as the eligibility requirements for the conversion are satisfied (book losses, liquidation or insolvency ordered by the court).

If the net tax payable for a given tax period is higher than the amount generated in respect of DTAs in that period, the excess may be used to be treat DTAs generated in prior periods or in the two next following tax periods as eligible for monetization. In these cases, the 18 year period established for the option to exchange them for government securities will run from the last day of the tax period in which the excess net tax payable that was used to made them into monetizable DTAs was obtained.

In the case of taxpayers under the consolidated tax group regime we consider that the monetizable DTAs will have to be determined by reference to the consolidated net tax payable figure

Where the right to monetization is elected, the entity will have to include certain information in its corporate income tax return: total amount in respect of DTAs, total amount and year of generation for the DTAs giving entitlement to the conversion (with specification of those not originally giving entitlement but came to do so because the entity obtained an excess net tax payable with respect to the DTAs generated in the period) and the total amount and year of generation for the DTAs not giving entitlement to conversion for the taxpayer.

All the other elements related to monetization remain unchanged from the previous wording (when the conversion must be made, election for offset or payment, reference to the implementing regulations, etc.).

2.2.2 DTAs generated in tax periods that began before January 1, 2016

According to the new wording of transitional provision thirty-three, the provisions in articles 11.12 and 130 LIS will apply to the DTAs generated in tax periods before January 1, 2016, regardless of the net taxable income figure for the tax period in which they were generated.

If, however, the difference between the amount of the DTAs and the aggregate sum of the net corporate income tax payable figures, for the tax periods ended between 2008 and 2015 is positive, for those DTAs to qualify for monetization the entity will have to pay, in respect of that difference, a public levy as defined in the new additional provision thirteen LIS (discussed below). That public levy must be paid in all the tax periods in which pre-2016 DTAs qualifying for monetarization are recorded.

For the DTAs in respect of provisions in tax periods before 2008, it may be inferred that it will not be necessary to pay the public levy for them to be treated as monetizable on or after January 1, 2016.

A rule on the order for inclusion is established here also, under which the provisions to which the public levy applies must be included in the tax base first, which allows the public levy payable in each period to be reduced.

Additionally, if in a tax period the positive net tax payable exceeds the amount of the DTAs generated in that period, the excess may be used first to reduce the DTAs in respect of which the public levy must be paid (except as provided otherwise in paragraph two of article 130.1 LIS).

Lastly, disclosure obligations are also laid down in relation to the DTAs generated in tax periods that began before January 1, 2016: the total amount of the DTAs, the total amount of the aggregate sum of the positive net tax payable figures generated between 2008 and 2015, the total amount and year of generation for the DTAs to which the public levy applies and the total amount and year of generation for the monetizable DTAs that do not give rise to the obligation to pay the public levy (specifying any that may fall outside the levy as a result of applying the excess net tax payable obtained in a given tax period).

2.3 New additional provision thirteen: public levy in respect of the monetization of DTAs

This applies to taxpayers that have recorded DTAs generated before January 1, 2016 (we consider that it refers to those generated between 2008 and 2015), where the difference between their amount and the aggregate sum of the positive net tax payable figures between 2008 and 2015 is positive, if the taxpayer intends to claim its right to monetization.

The public levy will be 1.5% of the total amount in respect of those DTAs existing on the last day of the tax period (we consider that this refers to the positive difference referred to above). The provision does not specify whether partial monetization is an option, allowing the taxpayer to elect to monetize only a portion of the DTAs subject to the payment of a public levy on their monetization.

The levy will fall due on the start date of the voluntary period for the corporate income tax return, and the payment period will be the same as the period established for self-assessment, although the formalities remain to be implemented by an Order of the Ministry of Finance and Public Authorities.

It is designed therefore as a public levy, not as a tax charge (as mentioned in the reasoning for the amendment), and is established in the General State Budget Law, similarly to other public levies established in the past.

Further provisions on the public levy are provided in additional provision thirteen:

- The power to collect the levy lies with the Spanish tax agency.
- Its management, examination and collection will be governed by the provisions in General Taxation Law 58/2003, of December 17, 2003 and in its implementing legislation.

- The tax agency's decisions may be appealed in appeals for reconsideration, in economic-administrative claims (proceeding in a first and only instance and an "abbreviated" proceeding) and in the appeals in the economic-administrative jurisdiction allowed in the General Taxation Law.

- Written ruling requests may be submitted to the tax authorities, with the effects set out in article 89 of the General Taxation Law.

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