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TAX NEWSLETTER

GARRIGUES

Judgments, Decisions, Rulings, Legislation of Interest

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1.News update

1.- Supreme Court rules that the Spanish consolidated tax group regime was contrary to EU law when it did not allow sister companies to be consolidated

Before the current Corporate Income Tax Law (Law 27/2014), Spanish legislation only allowed consolidation where the parent company was Spanish and this parent company's interest in the controlled companies (also Spanish) was owned directly or through other Spanish companies. In other words, neither horizontal consolidation ("among sister companies") nor indirect consolidation were allowed.

In different judgments, the European court (CJEU) has concluded that the consolidated tax group regimes in France (Judgment of November 27, 2008 in case C-418/07), the Netherlands (Judgment of June 12, 2014 in joined cases C-39/13 and C-41-13) and the United Kingdom (Judgment of April 1, 2014 in case C-80/12) were contrary to EU law due to not allowing this type of consolidation.

In view of the Spanish regime's similarity to the ones in those states, the current Corporate Income Tax Law now allows those types of consolidation (horizontal and indirect) for fiscal years that began on or after January 1, 2015. What happens then for earlier periods when companies could not be consolidated under a correct set of rules?

In a decision rendered on March 8, 2018, TEAC (the Central Economic-Administrative Tribunal) acknowledged that "horizontal consolidation" was already applicable under the previous legislation (before being expressly implemented in the new Corporate Income Tax Law, in other words) as a result of the CJEU's judgment rendered on June 12, 2014 in the Netherlands case. So, although TEAC acknowledged that its powers did not include the authority to conclude as to whether or not a given Spanish provision was precluded by EU law, the principles of primacy and direct effect of EU law made it obligatory not to ignore the CJEU's case law for a case similar to that of Spain.

The Supreme Court has now reiterated this conclusion in a judgment rendered on June 11, 2018, also referring to the judgment in the Netherlands case. It has closed the door, however, on applying for refunds in relation to statute-barred periods (as a result of the financial liability of the government) because there is no specific decision by the CJEU on Spanish law, despite the similarity between the repealed Spanish regime and the Netherlands regime on which the CJEU's judgment was delivered.

2.Judgments

1.- Corporate income tax.- A company should not be barred from using losses of permanent establishments in other states, when they can no longer be used by the permanent establishments themselves

Court of Justice of the European Union Judgment of June 12, 2018, case C-650/16

The Finnish branch of a Danish company had accumulated losses when it was closed, so its Danish parent company asked to be able to deduct those losses. Under the Danish corporate income tax legislation, however, it is not allowed for the income and losses of their permanent establishments in other member states to be included in the tax bases of companies resident in Denmark, unless the Danish company has elected the scheme of international joint taxation, which had not occurred in the case at issue, for which reason the Danish tax authorities did not allow that deduction. Those losses could have been deducted, however, if the branch had been in Denmark.

The CJEU made the following analysis:

a) The Danish scheme of international joint taxation results in all the companies in a group including their permanent establishments being taxed in Denmark, which means that the income of their permanent establishments situated in other countries is taxed in Denmark, but also that the losses of those establishments may be deducted.

   By contrast, the standard scheme allows an exemption for the income of permanent establishments situated in other countries, while simultaneously not allowing the deduction of their losses, whereas the income of permanent establishments in Denmark may be included in the tax base.

   Both schemes, therefore, may give rise to advantages or disadvantages according to the circumstances involved, and taxable persons have the freedom to be taxed under one scheme or the other. The requirements laid down to be eligible for international joint taxation are very strict, however. Among others, the election to be taxed under this scheme is made for a term of at least ten years.

   It may be inferred therefore that the Danish Corporate Income Tax Law gives rise to a difference in treatment between Danish companies with permanent establishments in Denmark and those having permanent establishments in other member states, which is liable to make exercising their freedom of establishment by setting up permanent establishments in other member states appear less attractive.

b) The objective of the legislation is justified because it is intended to prevent double taxation of profits and double deduction of losses of nonresident permanent establishments, so that every company is taxed in line with its ability to pay tax. Yet the ability to pay tax of a company with nonresident permanent establishments which have definitively incurred losses is affected in the same way as that of a company whose resident permanent establishment has incurred losses. It follows from this that the difference in treatment between one type of company and another concerns situations that are objectively comparable.

c) This difference in treatment cannot be held proportionate in cases where the permanent establishment in another country accumulates losses and is closed. Because in those cases there is no longer any possibility of deducting the losses of the nonresident permanent establishment in the member state in which it is situated and the risk of double deduction of losses no longer exists either.

d) It must therefore be concluded that the Danish legislation is contrary to the freedom of establishment.

2.- Corporate income tax.- It is valid to use premises for the business and hire a worker to be able to claim the reduced rate

Castilla y León High Court. Judgment of March 9, 2018

The company rented premises and hired an employee to carry on its business, which entitled it to claim the reduced corporate income tax rate. Castilla y León High Court held that it is irrelevant whether the taxable person's objective was precisely to claim the reduced rate, because the truth is the rental and the hiring of an employee took place, and so the requirements to claim that reduced rate were satisfied.

3.- Nonresident income tax.- Dividends paid to nonresident collective investment vehicles may not be subject to withholding tax if the same withholding tax does not apply to resident vehicles

Court of Justice of the European Union Judgment of June 21, 2018, case C-480/16

The court examined a case involving collective investment vehicles in transferable securities (UCITS) resident in the United Kingdom and in Luxembourg with investments in Danish companies and offering products to clients resident in Denmark. Distributed dividends on Danish investments were subject to

withholding tax in Denmark; whereas UCITS resident in Denmark may be eligible for an exemption, if: (i) they are resident in Denmark and (ii) calculate and report a minimum distribution of dividends.

The CJEU held that this legislation was contrary to the free movement of capital.

4.- Inheritance tax.- Inherited property transferred to a third party is liable to tax in the proportion it bears to the whole inheritance

Supreme Court. Judgments of June 5 and 7, 2018

According to the Supreme Court, assets or rights acquired by inheritance which are later sold to a third party not protected by evidence obtained through registration (in the case of property able to be registered) or who fails to substantiate that the acquisition was made with good faith or just title in an establishment open to the public (in the case of movable or immovable property), are subject to inheritance tax in the proportion that the audited value of that property and those rights bear to the inheritance received by the transferor.

5.- VAT.- The rental of a property by a holding company to its subsidiary is an economic activity giving entitlement to the deduction of VAT

Court of Justice of the European Union Judgment of July 5, 2018, case C320/17

In relation to the deduction of the input VAT paid by holding companies, the CJEU explained in this judgment that:

(a) The rental of a property by a holding company to its subsidiary entails "involvement in the management" of the subsidiary, in other words, an economic activity that entitles the company to deduct VAT on the expenditure incurred by the holding company to acquire its subsidiary.

(b) If the holding company has more than one subsidiary but involves itself in the management of only some of those subsidiaries, it does not mean that it carries on an economic activity with regard to the others. As a result, the VAT paid in respect of the expenditure relating to the acquisition of securities is only partially deductible, in accordance with the method of calculation defined by each member state which objectively reflects the part of the input expenditure actually to be attributed to economic activity.

6.- Transfer and stamp tax.- The exemption for housing under an autonomous community's official protection system must satisfy the central government's parameters for officially protected housing

Supreme Court. Judgment of May 22, 2018

The Supreme Court concluded that for housing under an autonomous community official protection system to qualify for the exemption in the law on transfer and stamp tax, the parameters to be met are those defined in the central government legislation determining the characteristics of officially protected housing (VPO) because otherwise the autonomous community legislation would be allowed to restrict or broaden the tax benefits granted by the central government legislation.

7.- Tax on increase in urban land value ("IIVTNU").- The tax must be paid if an increase in land value has taken place

Supreme Court. Judgment of July 9, 2018

As reported in our Tax Alert 12-2018, the Supreme Tribunal recently concluded that the tax on increase in urban land value must be paid on transfers of properties in which an increase in value has occurred.

See our Alert for further details (http://www.garrigues.com/es_ES/noticia/el-supremo-determina-que-si-hay-incremento-de-valor-de-los-terrenos-urbanos-procede-el-pago).

8.- Tax procedure.- On the protection of legitimate expectations in relation to a change of interpretation by the tax authorities

Supreme Court. Judgment of June 13, 2008

From a given date, the tax authorities started charging transfer tax on purchases of articles made of gold and other metals by private companies even though no change had occurred in the legislation on this subject. At issue was whether this is at odds with the principle of legitimate expectations, especially since, under their new interpretation, the tax authorities issue assessments in relation to earlier transactions in non-statute barred years.

The Supreme Court's reply was negative. The court held that the principle of legitimate expectations does not apply if there are no acts or external signs conclusive enough to convince the taxpayer reasonably of the tax authorities' unambiguous intention in the direction concerned. So, the fact that the same type of adjustment had not been made in the past does not imply that the tax authorities interpreted that those transactions were not subject to transfer and stamp tax, nor does it amount therefore to estoppel barring the authorities from charging the tax in respect of earlier non-statute barred periods.

9.- Tax procedure.- A person held liable for tax has the right to apply for an expert appraisal made at the taxpayer's instance

Supreme Court. Judgment of May 22, 2018

The Supreme Court has acknowledged that an expert appraisal may be made at the taxpayer's instance to refute both the audit of reported values that has served as the basis for a tax assessment, and any that may occur in the context of a procedure for declaration of liability for the payment of tax.

For this reason, the tax authorities must inform of that option in the decision declaring liability. So, although the absence of information in this respect does not affect the validity of the decision, it does stop the clock on the statutory time limit for applying for an expert appraisal made at the taxpayer's instance.

3.Decisions

1.- Corporate income tax.- TEAC clarifies how to calculate the 70% limit on depreciation in cases of items under finance lease agreements

Central Economic-Administrative Tribunal. Decision of June 7, 2018

For several fiscal years, the deduction of the depreciation of assets has been restricted to 70%.

In relation to items under finance lease agreements, TEAC has confirmed the interpretation that the limit on the deduction for tax purposes of depreciation applies to the lower of the following amounts: (i) the portion of the finance lease payments that relate to recovery of cost of the item; and (ii) the amount obtained by multiplying the cost of the item by twice the rate for depreciation on a straight-line basis according to the approved official tables.

2.- Personal income tax.- In the dissolution of a condominium there is a capital gain or loss if the allocations are not made in proportion to the share in ownership

Central Economic-Administrative Tribunal. Decision of June 7, 2018

The Personal Income Tax law provides that no capital gain or loss occurs in dissolutions of condominiums.

TEAC concluded in this decision, however, that for a capital gain/loss not to exist, the allocations made to each owner must match their shares in ownership. So, if one of the co-owners receives property or rights with a higher value than he is entitled to receive according to his share in ownership there will be a capital gain/loss for the others. This also applies to indivisible property.

The opposite view to this decision was adopted by the Catalonia High Court, for example, in its recent judgment of February 1, 2018 (application 507/2015).

3.- Transfer and stamp tax.- The contribution of properties mortgaged to secure debts with third parties is subject to tax as a transfer for valuable consideration, even if there is no subrogation in respect of the debts

Central Economic-Administrative Tribunal. Decision of June 14, 2018

Company A had contributed to company B a property mortgaged to secure a debt that company A owed to company C. Company B was not expressly subrogated in respect of the debt, although the debt was naturally taken into account to appraise the value of the contributed property.

In this context, TEAC concluded that there are two taxable events for transfer and stamp tax purposes:

(a) One subject to the tax as a corporate transaction (capital duty), on the value at which the property is contributed to the company, which relates to the paid capital figure.

(b) Another subject to the tax as a transfer for valuable consideration, by reason of the transfer in payment for assuming debts, even though the beneficiary of the property is not formally subrogated in respect of the debt, due to the fact that this debt was taken into account to determine the value of the contribution. In short, it must be interpreted that there is a "tacit subrogation" in respect of the debt, and therefore, that the taxable event related to an express transfer in payment for assuming debts arises at the beneficiary.

4.- Management procedure.- A request for a report on an audited reported value does not stop the clock on the statute of limitations period if the taxpayer is not informed

Central Economic-Administrative Tribunal. Decision of June 14, 2018

TEAC concluded in this decision that the request for an report on an audited reported value does not stop the clock on the statute of limitations period if the taxable person concerned is not officially notified that the request was made. All of the above in line with (i) the interpretation laid down by the Supreme Court in a judgment rendered on October 31, 2012 and (ii) the provisions in article 102.4 of the regulations on managing, collecting and auditing taxes, which require both periods of justified interruption and delays for reasons not attributable to the tax authorities to be adequately reported for them to be recorded in the case file.

5.- Collection procedure.- A person required to fulfill an attachment order is not allowed to decide to stop paying without authorization from the tax authorities

Central Economic-Administrative Tribunal. Decision of June 28, 2018

The taxable person received a notice requiring him to pay his debts (in respect of a property lease) payable to a third party under an attachment order, to the public finance authority. Later, the party under an attachment order sent a notice to the debtor stating that he no longer owned the leased property, and therefore all future rent payments under the lease had to be paid to the new owner. As directed in this notice, the debtor stopped making the rent payments under the lease to the public finance authority and started making them to the new owner of the property.

TEAC objected to this step and set as a standard that it is not up to the person required to fulfill an attachment order to decide the consequences of any modification affecting his creditor (the person under the attachment order). In cases of the type examined, the only option available to the debtor is to notify that modification to the tax authorities for them to instruct him how to act.

Moreover, a unilateral step by the party required to fulfill an attachment order by altering any of the elements of that fulfillment, if fault or negligence is involved, is a factual premise for declaring joint and several liability.

6.- Collection procedure.- The enforcement period begins when an application for deferral is discontinued and the tax debt is not paid simultaneously

Central Economic-Administrative Tribunal. Decision of June 28, 2018

When an application for deferral made in the voluntary payment period is discontinued, its discontinuance must be accompanied by full and immediate payment of the debt, because it is not allowed to keep the stay of enforcement of the debt in force after the application has been discontinued. Otherwise, the enforcement period begins.

7.- Collection procedure.- An injunctive stay remains in force until a decision on the ancillary stay proceeding

Central Economic-Administrative Tribunal. Decision of June 28, 2018

A taxpayer had applied for a stay of enforcement of a tax debt in the economic-administrative jurisdiction with a type of security other than those envisaged in article 233.2 LGT (General Taxation Law), which determined an injunctive stay of the collection procedure. That application was denied by the collection authority, and against that decision the taxpayer lodged an application for the relevant ancillary stay proceeding. In parallel, and before a decision was rendered on that ancillary proceeding, an enforced collection order was issued.

In this context, TEAC changed its interpretation and concluded that the injunctive stay granted with the initial application for stay must be maintained until the decision on the ancillary proceeding by the competent court, which made the notified enforced collection order unlawful.

4.Rulings

1.- Corporate income tax.- The capitalization reserve for tax groups is not calculated simply by aggregating the equity of the companies in the group

Directorate General for Taxes. Ruling V1836-18, of July 22, 2018

The DGT has issued a ruling in which it changed one of its interpretations in relation to use of the capitalization reserve in tax groups.

Among other findings, it affirmed that, to determine the increase in equity, after aggregating the increases in equity at each of the companies in the group, the applicable eliminations and inclusions of internal income and expenses need to be made.

2.- Corporate income tax.- Two part-time employees do not equal one full-time employee

Directorate General for Taxes. Ruling V1436-18 of May 29, 2018

The leasing of real estate may be regarded an economic activity if at least one employee is engaged full-time under an employment contract for the purpose of organizing the activity. This requirement is not met, however, by having two or more workers under part-time employment contracts. At least one of the employees must have a full-time employment contract.

3.- Personal income tax.- Leased student housing properties are allowed to benefit from the reduction to rent

Directorate General for Taxes. Ruling V1236-18 of May 11, 2018

The DGT's general interpretation is that the 60% reduction for residential leases is not applicable to seasonal leases.

In the case of student housing properties, it may be regarded they do not involve seasonal leases if, as

occurred in the specific case examined, the rent is agreed for a term longer than a year and the property is provided primarily to satisfy the student's permanent need for housing over the academic year.

5. Legislation of interest

1.- The Budget Law for 2018 has been published and various orders have been amended to adapt them to the law

The General Budget Law for 2018 (Law 6/2018 of July 3, 2018) was published in the Official State Gazette -July 4, 2018 issue-.

For further details see our Tax Commentary 6/2018, available at:

http://www.garrigues.com/sites/default/files/documents/novedades_tributarias_de_la_ley_de_presupuestos_2018.pdf

Later, the Official State Gazette -July 18, 2018 issue- published **Order HAC/763/2018 of July 10, 2018** (entering into force on July 19, 2018), amending the orders that approved:

(a) Form 143 for requesting early payment of the personal income tax credits for large families and dependants with disabilities (Order HAP/2486/2014, of December 29, 2014)

(b) Form 122 "Personal income tax. Tax credits for large families, for dependants with disabilities or for each ascendant with two children, who is legally separated or has no marital ties. Adjustment related to the right to the tax credit for taxpayers not obliged to file a return" (Order HFP/105/2017, of February 6, 2017).

(c) Form 136. "Personal income tax, corporate income tax and nonresident income tax. Special tax on certain lottery and betting winnings. Order HAP/70/2013, of May 30, 2016. Self-assessment" (Order HAP/70/2013, of January 30, 2013).

These amendments were made to adapt the foregoing forms (i) to the increases in the tax credits for large families and dependants with disabilities, and (ii) to the higher exemption threshold for the special tax on certain lottery and betting winnings, introduced in the Budget Law.

In relation to the increase in the tax credit for each additional child in a large family, it is provided that taxpayers who applied for early payment of the tax credit for large families before the entry into force of the Order will not have to apply for early payment of the increase in the tax credit because this will be done automatically by the tax authorities.

The Order will be applicable to applications for early payment of tax credits for large families and dependants with disabilities that are filed on or after August 1, 2018; and for self-assessments of the special tax on certain lottery and betting winnings in the first quarter of 2018 and thereafter.

Lastly, **Order HAC/748/2018 of July 4, 2018** (published in the Official State Gazette on July 14) amended article 2 and the annex to Order HAP/2652/2012, of December 5, 2012, which approved the refund tables applicable by institutions authorized to participate as approved institutions in the VAT refund procedure for travelers. This amendment arises also from the recent Budget Law, which has removed the minimum total invoice amount that used to be required to be able to claim a refund of the input VAT paid on purchases made by travelers.

2.- Publication of the annual equivalent rate for the third calendar quarter of 2018, for the purpose of characterizing certain financial assets for tax purposes

The Official State Gazette -June 29, 2018 issue- published the Decision of June 27, 2018, by the Secretary

General for the Treasury and Financial Policy which, as has become customary practice, provides the applicable reference rates to calculate the annual equivalent rate to characterize certain financial assets for tax purposes, this time for the third calendar quarter of 2018. The rates are as follows:

- Financial assets with terms of four years or less: -0.030 percent.
- Assets with terms between four and seven years: 0.269 percent.
- Assets with ten-year terms: 1.125 percent.
- Assets with fifteen-year terms: 1.464 percent.
- Assets with thirty-year terms: 1.780 percent.

In all other cases, the reference rate for the period closest to the period when the issuance is made will be applicable.

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