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IMMEDIATE COMMENTS ON THE POSSIBLE IMPACT OF BREXIT ON SPANISH TAX

INTRODUCTION

The Lisbon Treaty (which has been in force since December 2009), incorporated into the Treaty on European Union a clause allowing for the exit of a Member State from the Union (in article 50 of the TEU). Under that article 50:

- The State which has decided to leave the Union must notify the European Council of its intention and negotiate an agreement setting out the framework for its future relationship with the Union; and
- The formal exit notification has no immediate impact on the legal arrangements between the United Kingdom and the European Union. Its effects will come into force after at least two years, and this period may even be extended by mutual agreement if more time is required to negotiate the terms of the exit.

For the entire period over which the United Kingdom's exit is being negotiated, it will continue to be a European Union member to all intents and purposes and retain all the rights and obligations inherent in membership. All rules of European Union Law will continue to be applicable to United Kingdom residents.

The negotiations between the European Union (or EU), represented by the Commission, and the United Kingdom (or UK) will need to deal with the legislation on every area affected by EU Law—such as state aid, competition or extradition procedures—including taxation. Once the exit agreement has been reached, it will not need to be approved by all the EU Member States, only the approval of the European Union institutions being required.

There is therefore a chance that the United Kingdom will use the exit negotiations to reach a trade agreement allowing for freedom of movement of capital and free trade, in the style not only of the agreements which the European Union has traditionally held with the countries of the European Economic Area, but also of those recently signed by it with Canada or South Korea, or of the terms on taxation reflected in article 15 of the agreement with Switzerland.

It is to be noted, in any event, that the rules on freedom of movement of capital and payments (article 56 of the Treaty on the Functioning of the European Union, TFEU) also apply to third states, which is what the United Kingdom will be once it has left the EU. The areas likely to prove more problematic are the rules on the free movement of persons, particularly in relation to work and residence permits (we should remember that the United Kingdom did not sign up to the Schengen Agreement), or on the freedoms of establishment, of movement of goods or the freedom to provide services.

Lastly, there are also other international treaties which both the United Kingdom and the European Union have signed, such as the Agreement on the European Economic Area (EEA) which came into force on January 1, 1994 and was signed by the member countries of the EU and of the European Free Trade Association (EFTA), with the exception of Switzerland, which enabled the EFTA nations to form part of the European Union's internal market without having to join the EU. At this juncture, however, it is impossible to say whether this agreement will continue to apply to the United Kingdom once it has left the EU, since this is a matter to be decided during the exit negotiations.

TAX IMPLICATIONS IN SPAIN

Strictly from the angle of Spanish tax, the situation will only be clear once an exit agreement has been reached, since we cannot rule out that it may include safeguard clauses under which the tax directives (such as the parent-subsidiary directive, the directive on interest and royalty payments between associated companies and the directive on business restructuring operations) continue to apply to the United Kingdom.

Irrespective of whether or not tax clauses of this kind are included in the agreement to be signed by the EU and the UK, it must be also remembered that in the specific case of the relationship between Spain and the United Kingdom, there is a tax treaty in force, dated March 14, 2013, under which:

- Dividends paid to residents of the other Contracting State may be exempt from taxation if their beneficial owner is not a real estate investment vehicle and controls at least 10% of the capital of the payer company;
- Interest paid to beneficial owners resident in the other Contracting State are exempt from taxation at source;
- Royalties paid to beneficial owners resident in the other Contracting State are exempt from taxation at source; and
- Capital gains obtained by a resident of one Contracting State (e.g. in business restructuring operations) are taxable exclusively in such State of residence, except in the case of companies whose value is derived either directly or indirectly, to an extent of over 50 percent, from real property located in the source State.

Nevertheless, it would appear initially that the impacts on direct taxation of the United Kingdom's exit from the European Union (after it has actually taken place) will include, but not necessarily be confined to, the following:

- On **corporate income tax**:
  - Spanish companies transferring their residence to the UK would not be able to defer payment of the exit tax envisaged in article 19 of the Corporate Income Tax Law (LIS) in cases of changes of residence in which there are no elements linked to a permanent established in Spain.
  - Corporate transactions affecting UK residents would not be eligible for the tax neutrality regime for business restructuring operations. This would apply in changes of domicile between the United Kingdom and Spain of European Companies and European Cooperative Societies, as well as in any of the transactions (mergers, spin-offs, share exchanges and contributions of assets) in which the tax regime is conditional on the transferee or parent company, its shareholders, or the transferred asset being resident or located in an EU Member State (unless, in certain cases, the United Kingdom remains in the European Economic Area).
  - Gibraltar would be treated as a tax haven for all purposes, without the option of benefiting from the exceptions envisaged for tax havens that are members of the European Union in certain articles of the current Spanish Corporate Income Tax Law (LIS) (e.g. article 21.9 LIS for dividends and capital gains, article 22.7 for permanent establishment income, and article 23.2 on the reduction applicable to income from certain intangible assets).
  - There would not be possible to take the tax credit for research and development and technological innovation activities (article 35 LIS) for activities conducted in the United Kingdom (unless it remains in the European Economic Area).
  - UK affiliates of Spanish companies would not be eligible for the exception to the application of the Controlled Foreign Companies (CFC) rules set out in article 100.16 LIS (which is especially important if the United Kingdom ultimately reduces its nominal corporate income tax rate to 17% from 2020 onward, as it would be lower than 75% of the Spanish nominal rate).

- Shipping companies would not be eligible for the regime for shipping companies based on tonnage where the strategic and commercial management is carried out from the United Kingdom, or where all of the vessels affected are registered there.

- On **personal income tax (IRPF)**:
  - Spanish residents would not be able to apply the rule set out in article 14.3 of the Personal Income Tax Law (LIRPF), whereby deferred income is recognized as and when it is realized, without any penalties or late-payment interest or surcharges, in relocations of residence to the United Kingdom.
  - The listing in the UK would not give rise to the exception for shares listed in the EU from applying the special rule taxing them as income from movable capital in distributions of share premiums (art. 25.1 LIRPF) and capital reductions (article 33.3 LIRPF).
  - The listing in the UK would increase from 2-month to 1 year the period for reinvestments in like listed securities to preclude the computation of capital losses (article 33.5 LIRPF).
  - Shares listed in the UK would not be eligible for the special rule (article 37.1.a LIRPF) on the computation of capital gains on sales of listed shares.
  - Not eligibility for the special rules (reduction in the tax base for contributions—article 51.1.2 LIRPF—and valuation of compensation in kind for compensation paid by sponsors—article 43.1.1.e LIRPF) on contributions to pension plans regulated under Directive 2003/41/EC.
  - UK affiliates of Spanish residents would not be eligible for the exception to the application of the CFC rules set out in article 91.15 (which is especially important if the United Kingdom ultimately reduces its nominal corporate income tax rate to 17% from 2020 onward, as it would be lower than 75% of the Spanish nominal rate).
  - Reinvestment in shares in collective investment schemes that are set up and domiciled in the United Kingdom would not benefit from the tax deferral provided by article 94 LIRPF.
  - Transfers of residence to the UK would not benefit from the special regime for capital gains due to a change in residence (exit tax) set out in article 95bis.6 LIRPF.
  - The transitional regime for the reduction of capital gains on transfers of shares listed on European markets (transitional provision 9 LIRPF) would not be applicable.
  - The special (reduced) charge on prizes from certain lotteries and bets (Additional Provision 33 LIRPF) would not apply and, accordingly, prizes organized by the equivalent types of UK entities to the Spanish entities qualifying for this tax treatment will be taxed as a capital gains under the standard Personal Income Tax regime.

- On **nonresident income tax (IRNR):**
  - UK residents would not be eligible for the exemption for interest and income from the transfer of own capital, as well as for capital gains from movable property obtained other than through a permanent establishment, as set out in article 14.1 c) of the Nonresident Income Tax Law (LIRNR).
  - The exemption for dividends distributed to parent companies, pension funds or collective investment schemes, as set out in article 14.1 h), k) and l) LIRNR, would not apply to UK residents (unless the UK remains in the European Economic Area).

- The exemption for royalties paid between "associated" companies, as set out in article 14.1.m) LIRNR, would not benefit UK residents.
- UK resident individuals would not benefit for the exemption for reinvestment in the principal residence (additional provision 7 LIRNR).
- UK residents would not be entitled to deduct expenses directly related to income obtained in Spain and directly and inseparably linked to the activity carried on in Spain (article 24.6 LIRNR).
- The reduced 19% rate would not apply to UK residents and, therefore, the standard 24% rate would apply if income is not subject to another lower tax rate (article 25.1 LIRNR).
- The special regime whereby certain taxpayers resident in other EU Member States may elect to be treated as personal income taxpayers (article 46 LIRNR) would no longer be applicable to UK residents.

- On **wealth tax**:
  - Additional Provision four of the Wealth Tax Law, whereby nonresident taxpayers who are resident in an EU or European Economic Area Member State may be entitled to apply the autonomous communities' own legislation (tax benefits) in certain circumstances would not apply.

- On **inheritance and gift tax (ISD)**:
  - UK residents would not be eligible for the special rules on the adaptation of inheritance and gift tax legislation to the provisions of the judgment of the Court of Justice of the European Union, of September 3, 2014 (case C-127/12) with respect to additional provision two of the Inheritance and Gift Tax Law (option for nonresidents—resident in the EU—to apply the tax reductions approved by the autonomous communities).

The consequences for indirect taxation and, in particular, for Value Added Tax will be addressed in a separate publication, given the special relationship these taxes have with EU legislation.

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