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TAX NEWSLETTER

GARRIGUES

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1. Tax authorities cannot deny offset of a tax asset if its correctness has been recognized in a firm judgment

The Supreme Court has confirmed that, after the correctness of a tax asset has been examined and confirmed, the tax authorities are not allowed to question its use in a later year, on the basis of the substantive res judicata principle on which the court provided an interesting analysis.

The Corporate Income Tax Law gives the tax authorities a ten-year period in which to review tax assets (net operating losses, deductions, etc.), running from the end of the voluntary filing period for the return on the year in which they were generated, regardless of when they are actually used. In practice, this review takes place sometimes when the year in which the assets were generated is audited, and at other times when the year they were used is audited. But in both cases the aim of the review is whether the taxable person correctly generated entitlement to the tax asset in the year it arose.

In a judgment dated June 26, 2018 (appeal 299/2016) the Supreme Court noted that after a tax asset has been accepted by the tax authorities or the courts it may not be questioned again in a different year.

The specific case examined by the court concerned a company that had generated a net operating loss as a result of amortizing financial goodwill that was recorded in a later year. In an administrative proceeding it was discussed whether that amortization was allowable (and also, therefore, the net operating loss it generated) but it was accepted, in a firm judgment, following the appropriate court proceeding. The auditors, however, questioned the subsequent use of that net operating loss by arguing again that the amortization was not correct.

Against this, the Supreme Court concluded that the substantive res judicata principle applies to the net operating loss, and therefore the authorities' assessment in a subsequent year is null and void. The court recalled that substantive res judicata has a dual effect:

(i) An adverse or exclusive effect, whereby firm judgments preclude a subsequent proceeding based on an identical subject-matter to the proceeding in which the judgment occurred.

(ii) A positive or pre-litigation effect, implying that the matter that has already been judged in a first proceeding becomes an unavoidable precedent of the later proceeding (if the decision in the first is the logical forerunner for the subject-matter of the second).

2. Judgments

2.1 Corporate income tax -State aid / 'Tax lease'.- EIGs may be beneficiaries of state aid

Court of Justice of the European Union Judgment of July 25, 2018, in case C-128/16 P

In a decision rendered on July 17, 2013 the European Commission concluded that the so called "Spanish tax lease" was state aid. The General Court set aside that decision in a judgment dated December 17, 2015 (cases T-515 and 719/13) because it considered that the EIGs could not be beneficiaries of the state aid, which was contrary to the Commission's arguments. In the General Court's view, only the "investors" could be beneficiaries of the state aid (if it existed).

Going against the General Court's arguments, the CJEU has now concluded that the EIGs may indeed be beneficiaries of state aid insofar as they are not simply vehicles channeling aid to the "investors". For that reason, the CJEU has set aside the General Court's judgment, which means that the Commission Decision mentioned above automatically comes back into force.

Following the setting aside of the General Court's judgment, the CJEU has ordered reversion of the proceedings so that the General Court may rule on the grounds for setting aside submitted by the parties and which had not been analyzed by the General Court in its judgment; a decision that will ensure that the dispute will stay with us for a few more years.

2.2 Corporate income tax -State aid.- The selectivity requirement in relation to state aid must be assessed on the basis of a correct determination of the system of reference

Court of Justice of the European Union Judgment of June 28, 2018, in case C-203/16 P

German tax legislation allows tax losses to be carried forward and offset against income in later years. To prevent tax evasion, German lawmakers restricted the ability to carry forward losses of companies that had ceased trading to legally and economically identical companies (known as the "rule governing the forfeiture of losses").

In principle no exceptions were provided to the rule governing the forfeiture of losses (repealed with effect from January 2008). However, in certain cases involving the acquisition of shares to reorganize a company in difficulty, the tax authorities could allow the offset of prior years' losses.

In this context, the European Commission adopted a decision holding that the restructuring clause amounted to "unlawful" state aid. This decision was confirmed by the General Court in a judgment dated February 4, 2016.

The CJEU upheld an appeal lodged against that General Court judgment by concluding that the Commission erred in law when determining the relevant reference framework for examining the selectivity of the measure at issue (it took the view that the framework was constituted only by the rule governing the forfeiture of losses whereas it should have had regard to the general loss carry-forward rule).

In relation to this the CJEU held that the selectivity of a tax measure cannot be assessed on the basis of a reference framework consisting of some provisions that have been artificially taken from a broader legislative framework. And on that basis the CJEU set aside the EC decision after concluding that an error in the determination of the reference framework against which the selectivity of the measure should be assessed necessarily vitiates the analysis of the condition relating to selectivity.

2.3 Nonresident income tax.- Inbound expatriates taxed on principal residence

Madrid High Court Judgment of April 23, 2018

Taxable persons who become tax resident in Spain may elect to apply the "inbound expatriates regime" if a number of requirements are met. This regime implies basically that these taxable persons continue to be taxed as nonresidents for a few years subject to certain particular rules.

The nonresident income tax legislation generally applies the personal income tax legislation, which raises the issue of whether in the inbound expatriates regime the personal income tax rule applies which states that the principal residence is subject to tax on imputed income from real estate.

Madrid High Court concluded that this is not an option, because the inbound expatriate continues to be treated as a nonresident, which is not consistent with having their principal residence in Spain.

2.4 Tax on increase in urban land value.- Judicial review courts contradict Supreme Court

Supreme Court. Judgments of July 17 and July 18 2018

Madrid Judicial Review Court number 9 and Zaragoza Judicial Review Court number 2. Judgments of July 19, 2018.

The Supreme Court confirmed in two judgments the interpretation settled in a judgment rendered on July 9, 2017, summarized in Tax Alert 12-2018, on the constitutional nature of the tax on increase in urban land value.

In short, the Supreme Court reiterated that the Constitutional Court only held to be unconstitutional article 107.1 and article 107.2.a) of the Local Finances Law when the tax is charged in instances where no increase in land value has arisen, and therefore any assessments where there has been an increase in value are not void. For these purposes, the court accepted that the taxable person is allowed to provide any means of proof or indication of the absence of increase in value (the sale and purchase deeds for the property, for example), and the burden of proving that land value has in fact risen therefore lies with the tax authorities.

Some judicial review courts, however, have continued to find that following the Constitutional Court's judgments all assessments of the tax are void. They do not allow (and have expressly said so mentioning the supreme court judgment of July 9, 2017) "partial nullity" of the articles held unconstitutional by the Constitutional Court.

For the Madrid and Zaragoza courts the tax cannot be charged until the law is changed, insofar as there is no legal coverage for issuing assessments of the tax.

2.5 Tax procedure.- An assessment arising from a procedure not set out in the law is void and does not toll statute of limitations

Supreme Court. Judgment of July 2, 2018

As we reported in Tax Alert 12-2018, the Supreme Court has found that assessments issued in inappropriate procedures (in this case, a verification of information procedure implemented by the authorities in an instance not set out in the law) are void as matter of law and therefore do not toll the statute of limitations.

2.6 Penalty procedure.- Penalties not allowed on a company for infringements committed on its behalf but without its knowledge

Supreme Court. Judgment of July 17, 2018

In a criminal proceeding it was concluded that a number of acts were carried out by a third party without the company's consent and prejudiced the company, and so the company was not criminally blameworthy. The Supreme Court considered therefore that the company could not be penalized under administrative law either.

It recalled in any event that had an administrative penalty been allowed it would have had to be based on express, sufficient and detailed evidence of a breach of the duties of surveillance held by the company (fault in vigilando), after examining the circumstances of the case and determining which specific acts by the company had determined an infringement of that obligation.

2.7 Review procedure.- New evidence is allowed in the economic administrative jurisdiction

Supreme Court. Judgment of September 10, 2018

As it had found a previous judgment of April 20, 2017, the Supreme Court affirmed that in relation to an economic-administrative claim the examining authority must consider all items of evidence submitted to it and which are relevant to provide a response to the claim that has been brought, even if that evidence was not produced to the tax management or audit authorities.

The only exception is where the late production of evidence is the result of dishonest or malicious intentions on the part of the interested party, which must be evidenced in the case record.

2.8 Real estate tax.- Restriction placed on exemptions for buildings in which an education service is provided

Supreme Court. Judgments of July 26 and July 27 2018

The Supreme Court has placed restrictions in these two judgments for claiming the exemptions from the real estate tax legislation for buildings in which educational services are provided.

In its judgment of June 26, 2018, the court affirmed that at public hospitals where educational services are provided also, by operation of law the requirement for "direct use" of the building for educational activities is not satisfied. Therefore the exemption provided for publicly owned buildings used directly for educational services does not apply to them.

In the judgment of June 27, 2018 it affirmed that, for the exemption provided for subsidized private teaching institutions, the owner of the teaching institution must also be the owner of the land and buildings used for teaching purposes.

3. Decisions

3.1 Audit procedure.- After maximum period for completion of audit work has run, subsequent referral of the case to public prosecutor's office does not toll statute of limitations

Central Economic-Administrative Tribunal (TEAC). Decision of July 23, 2018

Following the interpretation determined by the Supreme Court in its judgments of November 3, 2011 and March 15, 2012, TEAC concluded that, after the maximum period for completion of audit work as set out in the repealed Law 1/1998, of February 26, 1998 on taxpayers' rights and safeguards (i.e. 12 months) has run, the statute of limitations for AEAT's right to make an assessment is not considered to be tolled as a result of the notification of commencement of audit work and, therefore, a subsequent referral of the case to the public prosecutor's office cannot be held to have the effect of tolling the statute of limitations period.

3.2 Tax on retail sales of hydrocarbons.- Entities acting as intermediaries between taxable person and end customer are not authorized to apply for a tax refund

Central Economic-Administrative Tribunal. Decision of July 23, 2018

TEAC recalled that, for taxes that are legally required to be charged to other individuals or entities, as in the case of the tax on retail sales of certain hydrocarbons, the individual or entity that has paid the tax is the party entitled to obtain a refund of incorrectly charged taxes if the following requirements are met: (i) the tax must have been charged on an invoice or document serving as an invoice –where the legislation governing the tax so provides-, (ii) the incorrectly charged amount of tax must have been paid over and not refunded by the tax authorities to the person to whom they were charged or to a third party; and (iii) the party with tax obligations that paid the charge must not be entitled to deduct their input tax.

On that basis, TEAC reiterated the interpretation determined in its Decision of February 15, 2017 and concluded that the entities acting as intermediaries between the taxable person for the tax on retail sales of hydrocarbon and the end customer are not entitled to apply for a refund of the tax, because when making the supply they charge the whole of the tax via the price to those acquiring the taxed products. It is therefore the end customers who bear the economic burden of the tax and are entitled to the refund of the tax on retail sales of hydrocarbons.

This same interpretation was determined by the Supreme Court in its judgment dated February 13, 2018.

4. Ruling requests

4.1 Corporate income tax.- Acquisition of an urban property by usucaption generates a taxable revenue

Directorate General for Taxes. Ruling V1854-18 of June 25, 2018

The request concerned the treatment for corporate income tax purposes of the acquisition by usucaption of a property.

After requesting a report from the Spanish Accounting and Audit Institute, it was concluded that the asset must be recognized for accounting purposes at its fair value, and a revenue is credited directly to net equity, on the date the judgment declaring the acquisition of the property is rendered. In other words, these acquisitions are recorded under the method for gifts.

That revenue must be taxed in the year it arises, which will match the year it is recognized for accounting purposes.

4.2 Corporate income tax.- Holding companies may use the capitalization reserve

Directorate General for Taxes. Ruling V1839-18 of June 22, 2018

The Corporate Income Tax Law places various restrictions for use of the capitalization reserve. None are provided in relation to holding companies, however, so these companies are allowed to claim this benefit if the other legal requirements are satisfied.

4.3 Corporate income tax.- Limits on offset of net operating losses under current Corporate Income Tax Law apply to transactions before its entry into force

Directorate General for Taxes. Ruling V1677-18 of June 13, 2018

The current Corporate Income Tax Law (in force for fiscal years beginning on or after January 1, 2015) places broader restrictions on the offset of tax losses than were established in the previous law.

The DGT considers that these restrictions, according to the current wording, apply to transactions performed before that law entered into force (for example, to the acquisition in 2014 of shares in a limited liability company, as described in the ruling request), because no transitional arrangements have been provided.

4.4 Corporate income tax.- A teaching institution is not a line of business

Directorate General for Taxes. Ruling V1581-18 of June 7, 2018

By performing a partial spin-off a company intends to transfer various private teaching institutions to other companies. The DGT concluded that a teaching institution does not in itself amount to a line of business, so the tax neutrality regime cannot be claimed for that transaction. It recalled that for a line of business to exist there must be an operational organization determining the independent existence of an economic activity, which does not occur in this case in relation to each teaching institution.

4.5 Personal income tax.- Rule on recurrence in preceding five years does not apply to clearly multiyear salary income

Directorate General for Taxes. Ruling V1645-18 of June 12, 2018

The personal income tax legislation contains a 30% reduction for salary income generated over more than two years, where, in the preceding five tax periods to the tax period in which it falls due, the taxpayer obtained other income generated over more than two years for which the reduction was claimed.

This reduction is also claimable for "clearly multiyear income", which is characterized as such in the Personal Income Tax Regulations.

The DGT confirmed that, according to a literal interpretation of the legislation, the rule regarding the "preceding five tax periods" is not applicable to clearly multiyear income.

4.6 Personal income tax.- Special valuation rules for income in kind do not apply to income from economic activities

Directorate General for Taxes. Ruling V1567-18 of June 6, 2018

The Personal Income Tax Law establishes that income in kind must be reported at market value, although it sets out certain specific valuation rules, for example for vehicles, the use of a dwelling owned by the payer or low-interest loans.

As the DGT affirmed, however, these special rules are only laid down legally for salary income. Therefore, the provision of a vehicle for work purposes generally has to be reported at market value, and the specific rules on salary income in kind do not apply.

4.7 Personal income tax.- Only securities representing investments in equity of companies or entities must be included to calculate the "exit tax"

Directorate General for Taxes. Ruling V1499-18 of June 4, 2018

Taxpayers who cease to reside in Spain must be taxed on unrealized capital gains from shares in companies over and above specific thresholds (exit tax). The law provides valuation rules for these purposes. Specifically, in relation to listed securities, it refers to "securities listed on any of the

regulated securities markets defined in Directive 2004/39/C". Although besides shares in companies, that Directive also refers to other types of securities such as bonds or other forms of securitized debt, for example.

The DGT has clarified that this reference to the Directive does not broaden the scope of the exit tax which only applies where shares are held in companies.

4.8 Nonresident income tax.- If authorities of another state do not issue a tax residence certificate, other means of proof are allowed

Directorate General for Taxes. Ruling V1530-18 of June 5, 2018

To be able to apply a tax treaty, evidence of tax residence is needed, and a certificate of tax residence issued by the competent authorities is considered the best means.

However, in instances where the tax authorities do not issue tax residence certificates (which occurs in Saudi Arabia, for example, which the DGT says it has confirmed), other means of proof may be considered.

4.9 Transfer and stamp tax.- Deeds amending the appraisal value of mortgaged properties are not subject to stamp tax

Directorate General for Taxes. Ruling V1914-18 of June 29, 2018.

The DGT has held in a number of rulings that deeds amending the appraisal value of a mortgaged property have valuable content, and therefore had to be taxed in respect of stamp tax. TEAC, however, found otherwise in a decision rendered on October 10, 2017. In view of this decision, the DGT has changed its interpretation to adapt it to TEAC's findings.

5. Legislation

5.1 Union Customs Code has been amended

In July and August, two delegated regulations were published (Delegated Regulations 2018/1063 and 2018/1118, respectively), amending Delegation Regulation (EU) 2015/2446, supplementing the Union Customs Code.

Without entering into a full analysis, the following three amendments are notable:

(a) Definition of "exporter": The conditions for being an exporter are limited to the essential requirements for the functioning of the export procedure, to allow greater flexibility in the choice of the person which may act as exporter, which will facilitate commercial relationships.

(b) Exchanges with special fiscal territories: Simplified procedures are established (customs formalities and controls) for exchanges between parts of the customs territory in which the VAT Directive applies. These procedures will also apply between parts of the customs territory in which the Directive does not apply (i.e. the Canary Islands in Spain's case), if they occur in the same member state.

(c) Financial solvency: In relation to the conditions for a reduction of the level of the comprehensive guarantee and the guarantee waiver, liquidity has been taken out as a stand-alone condition for evidencing the operator's solvency. In this respect, customs authorities must also take other elements into account, such as assets easily convertible.

5.2 New prepayment and corporate income tax return forms and new country by country reporting form

On September 14, 2018, the Official State Gazette (BOE) published Order HAC/941/2018, of September 5, 2018, amending the orders approving the forms for corporate income tax prepayments (form 202 and form 222), the general corporate income tax return form (form 200) and country by country reporting form (form 231). The most notable of these amendments were:

(a) Amendments to forms 202 and 222 (prepayments)

- It exempts private equity entities from the minimum prepayment applicable to large companies. This amendment will not apply, however, to prepayments with reporting periods that commenced before July 5, 2018.

- It includes the specific provisions (in relation to periods for self-assessment, payment and direct payments) contained in the provincial legislation for the Basque Country and Navarra for taxable persons subject to provincial legislation that are taxed jointly by central government and the provincial government.

(b) In relation to **form 200 (corporate income tax return)** it has been technically enabled to choose the option for the government to use 0.7% of the gross tax liability for activities in the public interest deemed to serve the welfare of the general public. The option will only be available to taxpayers whose tax period ended after the entry into force of the General State Budget Law for 2018 (July 5, 2018).

(c) The amendments to **form 231, the country by country reporting form**, are to include those introduced by the Corporate Income Tax Regulations in relation to the eligible entities that have to file country by country reports from January 1, 2019.

5.3 Canary Islands introduces SII (immediate supply of information) system in relation to Canary Islands general indirect tax

On August 7, 2018 the Canary Islands Official Gazette published Decree 111/2018, of July 30, 2018, amending Decree 268/2011, of August 4, 2011 approving the Regulations on management of the taxes under the Economic and Tax Regime for the Canary Islands, in which the most notable amendment is the introduction of the immediate supply of information (SII) system for the purposes of the Canary Islands general indirect tax.

See our Canary Islands Tax Commentary 2-2018 Todas las claves del sistema de Suministro Inmediato de Información en el ámbito de IGIC, available HERE.

5.4 Approval given to Protocol amending Belgium-Spain tax treaty

On August 2, 2018 the Official State Gazette (BOE) published the Protocol amending the Belgium-Spain tax treaty to update references to the competent authorities included in the treaty.

For further information:

Tax Department

Follow us:

GARRIGUES

Hermosilla, 3
28001 Madrid – Spain
T +34 91 514 52 00 **F** +34 91 399 24 08

www.garrigues.com