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The tax reform: key changes in the field of sport

Measures submitted for public consultation

On June 20, 2014, the Cabinet of Ministers approved four preliminary bills which propose a root-and-branch reform of several taxes.

These are preliminary bills, so they are subject to public consultation periods and, subsequently, to the relevant passage through parliament, where it is foreseeable that changes will be introduced into the current texts, which will have to be taken with the necessary caveats. However, there are already several proposed amendments that are affected by what is known as the "announcement effect", meaning that, if the reforms in question are finally approved, they will take effect in relation to taxable events that predate their entry into force.

Focusing on sports-related matters, we take a look here at certain measures that are adopted in the preliminary bill amending Personal Income Tax Law 35/2006, of November 28, 2006, and that affect the personal income tax treatment of sportspersons.

We also take a look at the amendment introduced by the Preliminary Bill for the Corporate Income Tax Law in relation to the tax regime applicable to events of exceptional public interest.

1. Severance pay

1.1 Exempt limit

As readers may know, the Personal Income Tax Law treats severance pay for dismissals or terminations as exempt income up to the amount established as mandatory in the Workers' Statute, in its implementing regulations or, as the case may be, in the legislation regulating the enforcement of judgments, whereas severance pay established in an agreement, clause or contract cannot be treated as such.

In the field of sport, after the Directorate-General of Taxes ("DGT") changed its view to adopt the Supreme Court's opinion, the exempt limit for sports professionals has been the minimum severance pay for unjustified dismissals established in article 15 of Royal Decree 1006/1985, that is, two months of their regular compensation, plus the proportional part of any pay supplements for work quality and quantity received in the past year, per year of service.

That said, the preliminary bill introduces a provision that generally restricts the exemption for severance pay to **€2,000 for each year of service provided which is computed to determine the amount of the mandatory severance pay**.

This restriction will apply to **severance for dismissals or terminations that take place on or after June 20, 2014**; however, where terminations arise from a collective layoff procedure, the restriction will apply to those which were not approved or notified to the labor authority before that date.

This change, which is the subject of much debate in the media, would enter into force if approved on the proposed terms, on the day following that on which the law is published in the Official State Gazette.

At the time of writing, the Spanish parliament is debating both a possible change to the date from which dismissals will be governed by the new rules, as well as the amount of the exemption itself.

1.2 Reduction for multi-year income

The preliminary bill essentially introduces the following changes:

- It reduces the rate of the reduction applicable to multi-year income (both income generated over two years, and income deemed obtained notably on a multi-year basis, such as income from the termination of an employment contract by mutual agreement) which becomes 30% (compared with the currently applicable 40%).

- For the reduction to apply, the income must be recognized in a single tax period (this requirement currently only applies to income obtained notably on a multi-year basis over time).

- The reduction does not apply to income generated over more than two years where in the five tax periods preceding that in which it becomes claimable, the taxpayer has received other income generated over more than two years to which the reduction was applicable.

As regards severance pay, the DGT has been taking the view that, as a general rule, taxpayers could apply to the non-exempt portion of the severance a 40% reduction for multi-year income generated over more than two years (subject to a ceiling of €300,000). This reduction would be pushed down to 30%.

Therefore, in relation to sports professionals, the DGT had been taking the view that if the generation period was longer than two years ("generation period" meaning the term of the contract) and the income was not regular or recurring, the reduction would apply.

Although we believe a technical adjustment will be made during the processing of the preliminary bill on this subject, according to the current wording of the requirement just mentioned, if a sportsperson receives an incentive to which the reduction applies and within five years he is dismissed and receives severance pay, he would not be able to apply the reduction to the non-exempt portion of the severance.

It should also be borne in mind that the preliminary bill keeps in place the general ceiling of €300,000 as well as the ceiling on the tranche of the severance between €700,000.01 and €1,000,000 and the inability to apply the reduction where the severance is higher than this last-mentioned amount.

With regard to this change, and specifically to severance pay, the preliminary bill establishes a **transitional regime whereby split severance pay arising from terminations of employment contracts or contracts for services that took place before June 20, 2014 can still qualify for the reduction** (subject to certain requirements). This transitional regime will also apply to dismissals that take place after this date where they arise from an approved collective layoff procedure or a collective dismissal notified to the labor authority before the dismissal takes place.

2. Special regimes

2.1 Special "inbound expatriates" regime

Article 93 of Personal Income Tax Law regulates what is commonly known as the "Beckham Law," by setting out the special regime applicable to workers who relocate to Spain and which, since its inception, has been applied by all sportspersons (with an employment contract) who relocate to Spain to play for their respective teams.

Broadly speaking, this regime allows individuals who become tax resident in Spain as a result of relocating to Spain, to be taxed for 6 years as nonresidents rather than as residents. In other words, the regime gives these individuals the option to be taxed at a flat rate (currently 24.75%) rather than at the rate determined using the regular tax scale on which the marginal rate ranges from 52% to 56%.[1]

The scope of the regime initially set out in the Personal Income Tax Law was cut considerably, effective on January 1, 2010, by restricting the regime to individuals meeting the other requirements laid down in the former legislation, whose expected compensation under their employment contract did not exceed €600,000 per year. Although this legislative amendment established a transitional regime for sportspersons who had acquired the right to apply the special regime before the amendment, the fact remains that the reform had a big impact on the sports business, by making certain signings more expensive or prohibitive.

As a fundamental change in the field of sport, the preliminary bill **excludes professional sportspersons subject to Royal Decree 1006/1985 from the special tax regime**. This exclusion is surprising given that the previous amendment that took effect on January 1, 2010 had already effectively excluded the highest paid sportspersons under employment contracts from the regime. We believe it would have made more sense to have maintained the quantitative limit than to exclude from the regime all sportspersons under an employment contract regardless of whether or not they earn less than €600,000 in a year.

The other new features introduced by the preliminary bill are, in brief, the following:

- Broadening of the regime to directors of entities who do not own holdings in their capital or, otherwise, where the holding does not trigger related entity status.

- Elimination of the requirements that work must actually be performed in Spain (given that all salary income will be deemed obtained in Spain), that the work must be performed for a company or entity that is resident in Spain and that the salary income must not be exempt from nonresident income tax.

- The regime will apply where income exceeds €600,000 per year although, up to that amount it will be taxed at 24% and at that amount and above at 45% (47% in 2015).

- Dividends, interest and capital gains on asset transfers will be taxed separately from other types of income, according to the scale for savings income: 19%, 21% and 23%. However, transitionally, in 2015 the rates will be 20%, 22% and 24%.

[1] The preliminary bill establishes lower rates for 2015, 2016 and thereafter.

The preliminary bill also provides for the application of a transitional regime that may affect sportsperson who have relocated to Spain before January 1, 2015, on the following terms:

> *"Taxpayers who relocated to Spain before January 1, 2015 may elect to apply the special regime provided for in article 93 of this Law pursuant to the provisions of that article and, as the case may be, in transitional provision seventeen, both of this Law, as worded at December 31, 2014, applying the tax rates established in the nonresident income tax legislation in force on the last-mentioned date, notwithstanding the provisions on withholding tax in the first paragraph of letter d)* (we believe that this is a mistake and that it should refer to the second paragraph of letter f*)) of article 93.2 of this Law."*

Consequently, as in the case of the amendment introduced in 2010, the preliminary bill establishes a transitional regime whereby taxpayers can elect to apply the regime as currently worded, provided that they relocated to Spain before January 1, 2015.

Likewise, those who relocated before January 1, 2010 to whom the ceiling of €600,000 per year did not apply can continue to apply the regime on the terms regulated in transitional provision seventeen of the Personal Income Tax Law as currently worded.

However, the transitional regime could—in our view by mistake—cause it to be considered in relation to withholding tax that taxpayers who elect to continue to apply the regime contained in transitional provision seventeen (as currently worded) are subject to the current withholding tax rules. As we have noted, we believe that the reference made concerning withholding tax to letter d) of article 93.2 of the Law in transitional provision seventeen (as worded in the preliminary bill) is incorrect. In fact, it is letter f) of article 93 that contains the new withholding tax rules, which could cause it to be considered that there is an obligation to withhold at the rate of 45% (or 47% in 2015) on income exceeding €600,000 even in cases of sportspersons who are taxed at the rate of 24% on income above €600,000 because the current transitional regime applies to them.

2.2 Capital gains due to change of residence

A new type of exit tax is introduced which is charged, as if it were a capital gain, on the increase in value of shares in any type of entity or collective investment vehicles of taxpayers who lose their status as such due to a change of residence.

It provides that this will occur if

- the taxpayer has had such status for at least five of the ten tax periods preceding the last tax period for which a personal income tax return must be filed; and
- the market value of the shares exceeds 4 million euros in aggregate or 1 million euros where the percentage holding in the entity is higher than 25%.

The capital gains will form part of savings income and will be attributed to the last tax period for which a personal income tax return must be filed. If necessary, a supplementary return will be filed, with no penalty, late-payment interest or surcharge whatsoever.

Specific rules are laid down for determining the capital gain.

Where the change of residence occurs as a result of a temporary relocation for work reasons to a country or territory that is not considered a tax haven, following a request from the taxpayer, the payment of the tax debt relating to these capital gains will be deferred by the tax authorities, subject to certain rules regulated in the regime itself.

Where the change of residence is to another member state of the EU or the European Economic Area with which there is an effective exchange of tax information, the taxpayer may elect not to self-assess the capital gain if he complies with certain circumstances (basically the taxpayer cannot transfer the shares, cease to be resident in the EU or in the European Economic Area and must notify certain information).

The taxation obligation will also apply where the change of residence is made to a country or residence considered a tax haven and the taxpayer does not forfeit his status as resident as a result of what is commonly known as "tax quarantine".

Further, for those who have elected to apply the inbound expatriates regime it specifies that the five tax periods required to be able apply this new exit tax would start to be computed from the first tax period in which the inbound expatriates regime does not apply.

This regime is not specifically for sports professionals, but certain profiles of athletes with high incomes and saving capacity could be affected by this new legislation.

2.3 Attribution of income under the international fiscal transparency regime

The preliminary bill makes certain amendments to the regime for the attribution of income in the international fiscal transparency regime which may have a particularly important impact for those in the sports and entertainment businesses.

Readers are reminded that this regime requires taxpayers where certain conditions are satisfied to attribute on their personal income tax returns the income obtained by non Spanish resident entities meeting a number of requirements.

Briefly, for this income to be required to attributed:

- The taxpayer must have an interest (individually or jointly with related entities or with family members including their spouse, up to and including the second degree) equal to or above 50 percent in the capital stock, the equity, the earnings or the voting rights at the nonresident entity.

- The nonresident entity must pay tax on the flowed through income at below 75% of what it would have had to pay on that income in Spain.

Taxpayers will have to attribute all the income obtained by the nonresident entity from the assignment or transfer of assets or rights or from the supply of services where the entity does not have the relevant organization of human and material resources to carry them out, unless it can evidence that it performs the transactions with material and human resources existing at a related non Spanish resident entity.

If the provisions of the above paragraph do not apply, the taxpayer will only have to attribute income from certain sources. In relation to what concerns us here, they would have to attribute any income from *"Industrial and intellectual property, technical assistance, real estate assets, **image rights** and the lease and sublease of businesses or mines …".*

Put concisely, if a Spanish-resident entertainer or sportsperson has an interest higher than 50% in a nonresident entity, which manages or exploits their image rights, and this entity pays a tax on that income which is below 75% of the tax it would pay in Spain, the entertainer or sportsperson would in principle have to attribute that income on their personal income tax return.

This regime would not apply where the non Spanish resident entity is resident in another EU member state, if the taxpayer evidences that it was incorporated for valid economic reasons and carries on economic activities.

3. Events of exceptional public interest

Article 27.3 of Law 49/2002, of December 23, 2002 on patronage sets out a special regime currently applicable to certain events that the law describes as "Events of Exceptional Public Interest".

In its current wording, the Preliminary Bill for the Corporate Income Tax Law eliminates the tax regime applicable to those events, except for events approved by law before June 20, 2014, which will continue to apply the preexisting regime.

This elimination may have a very important impact on Spanish sport. It must not be forgotten that the program of Spain's Olympic Sports Association (ADO) has been benefitting from this regime, which has helped fund the preparation of Spanish athletes for the Olympic Games.

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