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A recurring topic of debate with tax inspectors is whether it is legitimate to claim from companies the withholdings they did not make from their employees (or other recipients) where, when the authorities' review took place, those recipients had already reported the gross amount obtained in their personal income tax returns, and been taxed on the full amount. In these cases, the courts have made it clear that requiring the company to pay over those withholdings constitutes unjust enrichment for the tax authorities.

Where the recipients have not included that gross income, subject to withholdings, in their tax returns, the courts, at least to date, have been allowing the tax authorities to claim from the payer the withholdings not made, and they can impose penalties and claim late-payment interest.

But there can be another scenario, where the paying company pays over the withholdings to the tax authorities and the recipient does not agree to bear the cost of those withholdings, which often happens, for example, in disputed dismissals, where the company is required to pay into court the estimated gross amount of the severance payment .

Those cases have shown the existence of differences of interpretation by the various courts, some of which apparently disregard the mandatory withholdings to be made. At times, due to the long length of labor-related suits, companies do not know the amount of the withholding to be made but are required to pay the gross amount into court at the start of the proceeding. It would be reasonable to assume, in those cases, that, when the court case ends and the severance has finally been paid, the company would be allowed to recover the withholdings from that amount in order to pay them over to the tax authorities.

This does not always happen in practice, and the payer is required, at the time of the payment, to deliver the whole amount paid into court. To prevent the loss this entails for the payer, the Central Economic-Administrative Tribunal, in a decision dated October 25, 2012, held that a civil or labor court cannot ask a company to pay the gross amounts into court without subtracting the withholdings in question, given that the withholdings are required by tax legislation.

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1. JUDGMENTS

1.1 Corporate income tax.- Tax losses from statute-barred years cannot be audited (Andalucía High Court. Judgment of June 15, 2012)

In keeping with other recent court judgments (mentioned in previous bulletins), the Andalucía High Court held in this judgment that the tax authorities cannot audit tax losses generated in statute-barred years, even if they have been used in years open for review; and this with the current Corporate Income Tax Law already in force.

The court went against the tax authorities' interpretation to hold that the inspection authorities can only require the taxpayer to evidence the existence of the contested tax asset to verify the accuracy of its tax return, but cannot audit and reassess the book loss reported in a statute-barred year, as they can only audit and reassess non-statute-barred tax periods.

1.2 Corporate income tax.- Breach of formal requirements in electing to apply the special regime for corporate reorganizations does not prevent application of the regime (Supreme Court. Judgment of May 14, 2012)

In the case analyzed, the tax neutrality regime was elected for a spin-off. The inspectors disallowed the application of that regime because the election to apply it had not been recorded in the public deeds documenting the spin-off, or notified to the Ministry of Economy and Finance.

The Supreme Court concluded as follows:

- The special regime is an option for the taxpayer, and the member states cannot place obstacles hindering that option.

- Nonetheless, the election to apply the regime must be expressed in some way, so the requirement to place that election on record in some form is not contrary to Directive 90/434/EEC, of July 23, 1990.

- Given that, in this case, the entity had expressed its election in the corporate resolution (even though it had not done so in the public deeds or notified its election), the option can be considered correctly elected.

It must be borne in mind that this judgment was issued for a period in which Law 43/1995, of December 27, 1995, was in force, in its wording in force up to December 31, 2000; at that time, the law stated that the regime would apply if the taxpayer so decided, and its election had to be notified before the registration of the public deed. As the current law seems stricter in this respect, this judgment must be interpreted with caution.

1.3 Personal income tax.- The chosen (individual or joint) tax treatment option can be changed if elected because of mistake by tax authorities (Catalunya High Court. Judgment of May 16, 2012)

The State Tax Agency sent the taxpayer a draft personal income tax ("IRPF") return without including in it the total amount of salary income received by his spouse (salary income paid by a public entity). Due to this error in the draft return, the taxpayers confirmed its contents, and in doing so elected to be taxed jointly for personal income tax purposes (because they believed it was the most economically beneficial treatment for them).

Later, the claimants received a proposed provisional assessment increasing the personal income tax base by including the total amount of cash compensation not initially shown in the draft return. As a result of this new assessment, the taxpayers discovered that, in that case, individual tax treatment would have been more favorable, for which reason they elected to file late individual returns in the review proceeding.

The Catalunya High Court held that although the draft personal income tax return sent to taxpayers is always "merely for information purposes," it is evident that the taxpayers' initial decision to elect joint tax treatment was their own choice but was affected by the incorrect information provided by the tax authorities themselves (and with even more reason in this case, where the compensation not initially included in the draft was paid by a public entity).

1.4 VAT.- Research work or technical testing (ancillary to the main activity) carried out in a state does not constitute a VAT fixed establishment (European Court of Justice. Judgment of October 25, 2012, in joined cases C-318/11 and C-319/11)

The cases referred to two entities, one engaged in the manufacture of cars and the other of hearing aids. Both these entities carried out, in a member state other than the state where they conducted their primary activity, research and/or technical testing (for example, in the case of the car manufacturer, despite being established in Germany, it performs winter testing on its vehicles in Sweden).

The question raised was whether those entities could be deemed to have a fixed establishment in the state where they carry out that research work and/or technical testing.

The European Court of Justice ("ECJ") held that in order to consider that an economic activity is carried out for the purpose of deeming that a fixed establishment exists (and, thus, that a VAT refund must be applied for through the procedure for established rather than nonestablished taxable persons), taxable transactions must actually have been carried out, that is, transactions on which VAT is charged, as the mere ability of the establishment to perform those transactions does not suffice.

Thus, insofar as in the cases analyzed the entities do not charge VAT on the research activities and/or technical testing, they cannot be deemed to have a fixed establishment in the country where they carry out those activities, and therefore the refund of the VAT borne must be requested through the procedure for nonestablished taxable persons.

Moreover, this conclusion is not invalidated by the existence of a subsidiary in those countries

1.5 Tax on activities that have an impact on the environment in Castilla la Mancha.- Incompatibility with tax on economic activities (Constitutional Court. Judgment of October 31, 2012)

A reference for a ruling of unconstitutionality was made by Panel Two of the Judicial Review Chamber of the Castilla-La Mancha High Court, against article 2.1, letters b) and c), of Castilla La Mancha Parliament Law 11/2000, of December 26, 2000, regulating the tax on certain activities that have an impact on the environment. This tax is levied on the thermonuclear generation of electricity and the storage of radioactive waste.

The Constitutional Court held that the tax is unconstitutional because it has the same taxable event as the tax on economic activities, entailing a breach of article 6.3 of the Autonomous Community Financing Organic Law ("LOFCA"). In this regard, the court held that:

- Both taxes are levied on the mere pursuit of an economic activity, without there being data evidencing a non-tax aim in the autonomous community tax.
- That is because the new tax is not levied directly on the polluting activity but on the mere pursuit of an economic activity, consisting of the thermonuclear generation of electricity or the storage of radioactive waste.

1.6 Tax on large commercial establishments in Asturias.- Compatibility with tax on economic activities and with real estate tax (Constitutional Court. Judgment of November 6, 2012)

A claim of unconstitutionality was filed against additional provision one of Asturias Principality Law 15/2002, of December 27, 2002, on budgetary, administrative and tax measures. Specifically, among others, the claim referred to the tax on large commercial establishments in Asturias, which the claimant asked to be held unconstitutional because it taxes the same taxable event as the tax on economic activities and as the real estate tax.

The Constitutional Court referred to its judgment of June 5, 2012 (discussed in our bulletin of July 2012) and, when comparing the autonomous community tax to the tax on economic activities, it held that:

- A priori, we are dealing with a general tax (tax on economic activities) that affects all kinds of activities merely due to carrying them out, and is levied on potential wealth, and another specific tax that is levied only on certain activities, those carried out in large commercial establishments. However, the difference between taxable events is not enough in itself to consider that the prohibition under article 6.3 of the LOFCA does not apply.

- By comparing the quantitative elements of the two taxes it may be concluded that both taxes are levied very differently on economic capacity. In the autonomous community tax, the tax base includes the area used as a parking lot for the shopping mall, and the minimum area is 50% of the usable area for displaying and selling to the public; whereas, for the tax on economic activities, the area is only one fixed element chosen by the lawmaker as an indication of wealth in relation to the specific business sector. According to the court, *after determining the obvious dissimilarity between the tax bases…we can conclude that there are sufficient distinctive criteria to enable us to state that the contested provision observes the terms of the prohibition established in article 6.3 LOFCA*.

The same conclusion was reached after comparing the autonomous community tax with the real estate tax, because it was considered that the autonomous community tax is not levied on a building with certain measurements and used to carry on a commercial activity, so the taxable events do not coincide.

1.7 Collection proceeding.- Method for computing late-payment interest in the issue of new assessments after the previous ones have been overturned (Supreme Court. Judgment of October 25, 2012)

The inspectors issued a corporate income tax assessment which was contested by the taxpayer. The TEAC (Central Economic-Administrative Tribunal) partially upheld the claim, leading to the original assessment being overturned and a new one being issued, in which the late-payment interest was calculated up to the issue date of the new assessment.

In this judgment, the Supreme Court confirmed the new interpretation made in its judgments of June 14, 2012 (summarized in our October 2012 bulletin), once again holding that the last day for the computation of late-payment interest is the date on which the chief inspector issued the original assessment that was later overturned by a ruling or judgment.

1.8 Collection proceeding.- Validity of notice of order initiating enforced collection proceedings served at address provided for notice purposes in the public deed of sale of real estate even if it differs from tax domicile (Balearic Islands High Court. Judgment of July 24, 2012)

In the transfer of real estate, the taxpayer did not file a tax return for the tax on the increase in urban land value and, as a result, an order initiating enforced collection proceedings was issued and notice was served at the address the taxpayer had provided as its address for notice purposes in the public deed of sale.

The taxpayer contested the order on the ground of incorrect service of notice, because it had not been served at its tax domicile. The Balearic Islands High Court held, however, that the notice of the order initiating enforced collection proceedings served at the address specified by the seller for notice purposes in the public deed of sale is correct, even though it is not the taxpayer's registered office or registered domicile.

This view is debatable, considering that the address provided in the public deed is not the address used in the dealings between the taxpayer and the tax authorities but in those between the parties to the sale and purchase.

1.9 Inspection proceeding.- Right to a complete reassessment (Supreme Court. Judgment of November 5, 2012)

The taxpayer sold some real estate and recognized the relevant capital gain using the cash method (because it had received the price in installments over more than a year). The inspectors reviewed the first fiscal year in which the capital gain was partially allocated but not the following year, and allocated the whole of the capital gain to that first year. The authorities' assessment gave rise to double taxation.

In keeping with a settled precedent from the judicial review courts, the Supreme Court held that the tax authorities must try to make a complete reassessment of the taxpayer's position meaning that when a taxpayer is undergoing an inspection and its position is reassessed, they have to take into account all the components of the tax being reassessed, to prevent serious loss to the taxpayer.

The court insisted that reassessments are not only required in relation to elements that may cause a loss to the taxpayer but also in relation to elements that may benefit it.

2. DECISIONS AND RULINGS

2.1 Corporate income tax.- Allocation of tax prepayments by a tax group among its members (Directorate-General of Taxes. Ruling V1979-12, of October 15, 2012)

When a company leaves a tax group, it is entitled to deduct the tax prepayments made by the group, in the proportion in which it has contributed to them.

In this ruling, the DGT clarified that the proportion in which the entities leaving the group have contributed to prepayments will be determined as the proportion that the taxable income of those entities bears to the sum of all the taxable income of the companies making up the tax group in the relevant prepayments. In short, it appears that the companies that have contributed to the prepayment, by reducing it (because they have individual tax losses), are not entitled to deduct the group's prepayment by any amount.

2.2 Personal income tax.- Civil and labor courts do not have jurisdiction to decide on the withholding tax to be deducted from amounts paid in enforcing judgments by those courts (Central Economic-Administrative Tribunal. Decision of October 25, 2012)

Following a judgment against a defendant in a civil court and in the enforcement of the judgment, the defendant paid certain amounts to a personal income taxpayer. The

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defendant paid into court the net amount, after deducting the related withholding tax which was paid over to the tax authorities.

The court asked the defendant to pay into court also the amounts withheld and paid over to the tax authorities on the understanding that the payment into court should have been equal to the gross amount.

In view of this, the defendant applied to the tax authorities for a refund of the withholding tax paid over to them, because it had also been paid into the court by court order, thereby giving rise to a dual payment.

The tax authorities denied the refund of those amounts holding that the withholding is mandatory by tax law, meaning that the civil courts cannot rule on the appropriateness of the withholding and its amount.

The TEAC confirmed this conclusion and, moreover, added that the same conclusion would have been reached had the court order come from a labor court. This difference of interpretation between the courts of justice and the tax authorities can lead to problems in practice in which the taxpayer unjustifiably suffers a loss.

2.3 Nonresident income tax.- Refund to nonresident mutual funds or insurance companies of the withholdings borne on dividends from Spain: some issues (Central Economic-Administrative Tribunal. Decisions of October 25, 2012)

In these decisions, the TEAC analyzed two issues: (i) whether the denial of the refund of the withholdings made from the dividends paid to nonresident mutual funds or insurance entities was contrary to European law, and (ii) whether it is correct for the recognition (or denial) of the right to such a refund to be done through a data verification procedure.

The first case (Decision 00/2644/2009) involved a refund of the withholdings borne by a fund domiciled in the United Kingdom. Due to the refund application, a data verification procedure was initiated which ended with the refund being disallowed. The TEAC concluded that:

- The disallowance of the refund is contrary to European law, as it infringes the principles of nondiscrimination and preservation of the free movement of capital and the freedom of establishment.
- That is because if the refund is not made, the fund bears a final amount of tax in Spain at 15% (rate applicable at that time), while resident funds bear an effective rate of 1% (as they are able to recover the excess withholdings borne).
- The difference in treatment is not justified as nonresident funds are comparable to Spanish funds in terms of their investors and contents.

In the second case (Decision 00/3442/2009), the claimant was an insurance company resident in the United Kingdom that had also borne withholdings on dividends received from Spain. In this case, the claimant held that a Spanish insurance company owning at

least 5% in the payer (also Spanish) would be entitled to a tax credit for domestic double taxation, while the nonresident insurance company is not entitled to that tax credit, so the withholdings should be refunded.

The TEAC held that the principles of nondiscrimination and preservation of the free movement of capital and the freedom of establishment were not breached on the ground that the final taxation is very similar in both types of companies (resident or nonresident), since although resident entities can take the double taxation tax credit and are taxed on the net amount, in the case of nonresidents, the marginal rate is lower.

Also, in both decisions, and in relation to procedural aspects, the tribunal held that the data verification procedure cannot be used to verify entitlement to the refund in these cases, bearing in mind the complexity of the verification to be made and, in particular, the need to compare the law applicable to nonresidents and to residents, and analyze any possible breaches of European law, etc. For this reason, in the second case analyzed, although the TEAC determined that European law was not breached, it rendered null and void the proposed assessment because the tax authorities had used the data verification procedure.

2.4 Inspection proceeding.- The inspectors cannot review elements already analyzed before in a partial inspection (Central Economic-Administrative Tribunal. Decision of October 19, 2012)

In the case analyzed, a partial inspection had been carried out that had ended with a VAT assessment. Subsequently, in a new inspection, which was general this time, a new assessment was issued for the same tax and year.

The TEAC held that this new assessment was not allowable, as a portion of the corrected elements had already been reviewed in an earlier partial inspection that involved not a simple inspection but a legal characterization. This being so, they cannot again review the same elements that had already been inspected unless the inspectors carry out additional research work from which new facts arise that could not be known in the previous inspection.

In short, the scope of the second inspection will be conditioned by that of the first one, in respect of the same taxes and years.

3. LEGISLATION

3.1 Tax treatment of bank asset funds and of their unitholders

The Official State Gazette of November 15, 2012, saw the publication of Law 9/2012, of November 14, 2012, on restructuring and resolution of credit institutions. That law derives from Royal Decree-law 24/2012 which we summarized in our Updates-Corporate 23-2012, and Tax Bulletin August September 2012 newsletters, found at the following links.

http://www.garrigues.com/es/Publicaciones/Novedades/Documents/Novedades-Mercantil-23-2012.pdf

http://www.garrigues.com/es/Publicaciones/Boletines/Documents/Boletin-Fiscal-Septiembre-2012.pdf

The tax provisions contained in Law 9/2012 do not contain any changes with respect to the Royal Decree-law mentioned, except for the introduction of an additional provision seventeen on the tax treatment of bank asset funds and their unitholders:

- Royal Decree-law 24/2012 allowed the formation of groupings of assets and liabilities of an asset management company, which will constitute separate sets of assets, without legal personality.

- Those bank asset funds are subject to corporate income tax at 1%, being subject to the tax treatment provided for collective investment vehicles.

- Regarding the investors, the law establishes that where they are corporate income tax, nonresident income tax (if they obtain income through a permanent establishment in Spain) or personal income taxpayers, they will be subject to the treatment established for members or unitholders of collective investment vehicles. In the case of personal income taxpayers, however, they will be subject to the deferral regime established in the second paragraph of letter a) of Article 94.1.f the Personal Income Tax Law.

- Lastly, the income obtained by the investors subject to nonresident income tax without a permanent establishment will be exempt from that tax.

This tax regime will apply during the time the Fund for Orderly Bank Restructuring (FROB) is exposed to these funds. At the end of that period, they will be taxed at the standard corporate income tax rate. The expiry of that period will trigger the end of the tax period of the bank asset funds.

Moreover, the income generated at the unitholders of the bank asset funds after this period but which originates from the tax periods in which they were subject to the 1% corporate income tax rate will be subject to the treatment established for unitholders mentioned above.

3.2 Convention on Mutual Assistance in Tax Matters

The Instrument of Ratification of the Protocol of Amendment to the Convention on Mutual Assistance in Tax Matters, done at Paris on May 27, 2010, and the consolidated text of the Convention of Mutual Assistance in Tax Matters, done at Strasburg on January 25, 1988, were published in the Official State Gazette on November 16, 2012.

These amendments stem from the need to bring the Convention into line with the international standard on exchange of information for tax purposes and to open it up to the new cooperative framework. The amended Convention seeks to reinforce co-

operation between the tax authorities of different states with a view to combating tax fraud.

The Protocol will take effect for Spain on January 1, 2013.

3.3 Information on assets and rights situated abroad

November 24, 2012 saw the publication in the Official State Gazette of Royal Decree 1558/2012, of November 15, 2012, which implements new disclosure obligations and, in addition, with the goal of improving the mechanisms for obtaining information on assets, rights and activities, held, exercised or carried on abroad, contains changes which affect mutual assistance and the mutual agreement procedures between states.

This royal decree was already summarized in our November Tax Newsletter 9-2012, which can be found at the following link:

http://www.garrigues.com/es/Publicaciones/Novedades/Documents/Novedades-Fiscal-9-2012.pdf

3.4 Objective assessment method for personal income tax and special simplified VAT system for 2013

On November 30, 2012, the Official State Gazette published Order HAP/2549/2012, implementing the objective assessment method for personal income tax and the special simplified VAT system.

In general, the structure from 2012 is kept in place, with the following notable changes:

- The exclusive aggregates of the objective assessment method for personal income tax have been brought into line with the wording of article 31.1 of the Personal Income Tax Law approved by Law 7/2012.

- With regard to personal income tax, the amount of the modules and the net income indexes for agricultural and livestock activities and the instructions for applying them are kept in place. In addition, the general 5% reduction in net income from modules is retained for all taxpayers who determine their net income using the objective assessment method in 2013, and this reduction will be taken into account when determining net income for the purposes of tax prepayments. However, the net income indexes are not reduced for certain activities.

- With regard to VAT, the modules are brought into line with the new VAT rates in effect since September 1, 2012, taking into consideration that those rates will apply in 2013.

3.5 Invoicing obligations: new regulations

To comply with the requirements of Directive 2010/45, on December, 1, 2012, the Official State Gazette published Royal Decree 1619/2012, of November 30, 2012, approving the regulations governing invoicing obligations. The new regulations will apply from January 1, 2013, which is when the former regulations contained in Royal Decree 1496/2003 will be deemed repealed.

These regulations were already summarized in our VAT Newsletter 2 2012, which can be found at the following link:

http://www.garrigues.com/es/Publicaciones/Boletines/Documents/Boletin-IVA-Diciembre-2012.pdf

4. OTHERS

4.1 Amendments to the Bill adopting various tax measures

On November 27, 2012, various amendments were submitted in the upper house of parliament to the Bill adopting various tax measures aimed at shoring up the public finances and boosting economic activity, which is currently passing through the upper house, as is the General State Bill for 2013.

The main highlights from the amendments are as follows:

- **Severance pay for dismissal or removal**
  - It is proposed that the portion of severance pay for dismissals that exceeds €1,000,000, or the amount that is exempt from personal income tax if higher, not be deductible for corporate income tax purposes. The ceiling on the deduction will be calculated by reference to all the entities in the same group within the meaning of article 42 of the Commercial Code.
  - It is also proposed that where directors or members of the board of directors are removed, the 40% reduction (already restricted to a cap of €300,000) cannot be applied to severance pay exceeding the amount of €1,000,000 (reduced proportionally for severance pay between €700,000 and €1,000,000). It appears that this rule refers to the portion of severance that is subject to and not exempt from tax, although the wording of the amendment is not clear.
- **Tax treatment of residential leasing companies**: The requirements necessary to apply this treatment are relaxed by reducing the number of dwellings required and the period of time during which they must be leased. The dwelling size requirement is also eliminated.

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- The **tax treatment of SOCIMIs (i.e. Spanish REITs)** is amended in several respects. Most notably, the tax rate for income from the performance of the corporate purpose and specific aim is set at 0%.
- In the area of personal income tax, the possibility of **not allocating contributions to certain employee welfare instruments** is restricted to €100,000 per year per taxpayer.

Other noteworthy amendments include the modification of the **tax treatment** applicable to **finance lease agreements** or the creation of the **tax on deposits at credit institutions**.

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