November 2014

On November 7, 2014, the General Court of the European Union handed down judgments on the Autogrill España (T-219/10) and Banco Santander and Santusa Holding (T-399/11) cases. In both cases, it held that article 12.5 of the Revised Corporate Income Tax Law (which permits amortizing goodwill derived from the acquisition of shares in nonresident entities) does not constitute State aid whether the acquired entities are European Union residents or otherwise . On that basis, the Commission Decisions on both cases have been overturned.

The judgments are mainly based on the absence of selectivity in the measure in question, as it is potentially available to all companies.

Readers are reminded that this same year, the Commission adopted a third decision on this matter (dated October 15, 2014) where it defended the existence of new State aid due to the change in administrative practice (based on a tax ruling of 2012) when calculating financial goodwill in acquisitions of foreign entities with second-tier holdings.

In this latter proceeding, the Commission issued a decision on July 17, 2013, not only formally initiating the proceeding which would lead to the last decision, but also ordering Spain to cease applying this new interpretation. Although the above-mentioned judgments did not analyze this third decision, it seems reasonable to assume that the legal basis for this last decision depends on the lawfulness of the two previous decisions.

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I. Judgments

1. *Corporate income tax.- Real estate developer is not an asset-holding company even if it does not perform development activity directly (Supreme Court. Judgment of October 27, 2014)*

The Court analyzed whether or not the sale of real estate by a company that was awarded several properties, after the execution of a land reparceling project to which that entity had contributed certain land lots, constituted an economic activity. The inspectors considered that it did and, accordingly, concluded that it was not an asset-holding company and was subject to tax under the standard corporate income tax rules.

The Supreme Court analyzed the case and concluded as follows:

(a) Since its formation, the company had carried out a de facto real estate development activity. Moreover, it was registered under economic activities tax code 833.2, "real estate development of buildings," which is a voluntary act aimed directly at commercially pursuing that activity.

(b) Furthermore, making reference to previous court judgments, it concluded that the contribution of land lots by a company engaged in real estate development to a development apportionment entity, in order for the latter to develop and deliver to it the resulting plots, does not preclude the existence of a business activity by the contributing company. For this purpose, it is not relevant that the execution of the development works is done through a cooperative given that the decisive factor is not who performs the material execution but the fact of having land lots assigned to the company's activity which are included in a development project for their transformation and are transferred to third parties pursuant to the corporate purpose.

(c) Based on the foregoing, the Court held that the appellant engaged de facto in real estate development, and that all of its assets were used, therefore, in an economic activity, meaning that it could not be deemed an asset-holding entity.

(d) The Court added that the premises and employee requirement refers solely to the lease or sale and purchase of real estate, not to the real estate development activity, which is broader in scope.

2. *Corporate income tax.- On the scope of "valid economic reasons" for purposes of the special regime (Supreme Court. Judgment of October 27, 2014)*

The Court analyzed whether a reorganization had been carried out for valid economic reasons for purposes of applying the tax neutrality regime. The transactions analyzed were carried out between 100% investees of the same group of companies. In particular:

- "X" was the production company of the group, which sold the products in Spain and abroad.

- Another company, "Z", was the owner of most of the group's brands and obtained its income from licensing the industrial property mainly to "X".

- "Y" was the owner of various real estate properties and of shares in group companies in Spain and abroad.

The reorganization first included the acquisition of "Z" by "Y" (without "Y" having owned any interest in "Z" previously) and then the absorption of the former by the latter. The capital gains on the sale of the shares in "Z" were not taxed under personal income tax at the shareholders as a consequence of applying the abatement coefficients. Additionally, in the merger carried out under the special regime, the brands of the absorbed entity were revalued (this revaluation, as the Central Economic-Administrative Tribunal ("TEAC") stated, required the absorbing entity to own at least 5% of the shares in the absorbed entity, for which the prior acquisition was useful).

Prior to the registration of the merger on the Companies Register, the absorbing company sold to a Dutch company (entity related to the family group) some of the brand registrations that it had acquired previously through the merger, the sale price of which coincided with that of the revaluation.

Some months after the merger, an exchange was carried out, in which "Y" received shares in "X".

The appellant contended that the transactions were carried out to enhance the management of the brands through a structural modification ("*to integrate into a single business structure the management of the brands together with the management and administration of the production and distribution entities*") and to improve revenues, especially through royalties. All of that was backed by an expert's report supporting the advantages of vertical, as compared to horizontal, organization of companies.

The chamber of instance denied that those transactions entailed achieving the envisaged objectives. In fact, it stated that the final result of the transactions was certainly different from the planned result, and the management of the brands was placed at two entities (the absorbing entity and a related Dutch entity) while the production and sale of the products was placed at another different one ("X").

The Supreme Court shared the chamber of instance's opinion and held that:

(a) The anti-abuse provision expressed in the wording of the special regime ("mainly for aims of fraud or tax evasion") is not equivalent to fraud upon tax law, as its basis is more closely found in the prohibition of abuse of law and its anti-social exercise, including abusive practices carried out solely to benefit from the advantages provided in a law.

(b) Consequently, the Court recognizes the tax authorities' power to presume that aim in a teleological interpretation of the special regime, where there is an absence of valid economic reasons in the transaction carried out, shifting the burden of proving the existence of those reasons to the taxpayer.

(c) In short, it is not up to the tax authorities to evidence the existence of an unlawful or false transaction but to prove that the main aim was to obtain a tax benefit, due to the absence of another valid economic explanation, which is something the tax inspectors *did* justify.

The Supreme Court added, moreover, that the technical report was excessively general, appearing to be more of a theoretical opinion than the specific evaluation of the situation of the group of companies, so it was not valid for refuting the conclusion on the absence of valid economic reasons.

3. *Corporate income tax.- Tax amortization of financial goodwill (article 12.5) does not constitute State aid (General Court of the European Union. Judgments of November 7, 2014, in cases T-219/10 and T-399/11)*

On November 7, 2014, the General Court of the European Union handed down two judgments on State aid cases, ruling on two actions for annulment against two decisions of the European Commission in which the Commission considered as State aid the possible amortization of the so-called financial goodwill established in article 12.5 of the Corporate Income Tax Law.

(a) Decision 2011/5/EC, of 28 October 2009, relating to the amortization of financial goodwill in the case of acquisitions of shares in foreign companies resident in the European Union, contested and now overturned in case T-219/10.

(b) Decision 2011/282/EU, of 12 January 2011, referring to the amortization of goodwill in the case of acquisitions made outside the European Union, contested and overturned in case T-399/11.

In those judgments, the General Court focuses on the concept of selectivity of the measure. In order for a tax measure to become State aid, it must meet the criterion of selectivity, which requires not only that the measure can mean an exception in the tax system but that it must favor certain companies or goods, entailing an advantage for some companies in comparison to others in a comparable situation. In other words, there is not selectivity where the disputed regime is potentially accessible to all companies. The Court found that such selectivity was not present and that, in any case, the burden lies with the Commission to prove that there is a category of companies that are the only ones favored by the measure.

The Court repeated several important aspects of the Community case law on State aid: (i) that a measure is not, in principle, selective when its application does not depend on the activity of the beneficiary companies; and (ii) that a tax measure does not become State aid even if it entails a tax benefit for the companies of a member State, as selectivity must be found to exist within each State and not by comparison between the regime applicable in that State and in other member States. The Court added (iii) that State aid does not arise even if a national measure generally favors the export of capital.

Appeals for cassation can be filed against these two judgments before the Court of Justice of the European Union, within a period of two months. However, the potential appeal for cassation would not result in a stay of execution. Lastly, along these lines, we remind readers that the Supreme Court has recently given an opinion on procedures to recover State aid from the perspective of the national court. In this regard, in its judgments of October 1 and 9, 2014 (also discussed in this newsletter), the Court recalls that it is up to the national court to monitor the lawfulness of procedures to recover State aid in accordance with the Community decisions and judgments passed and with the Spanish authorities' proceedings.

4. Income tax.- A provision entailing flat-rate taxation of the income from investment funds is contrary to the free movement of capital even if it is justified by the breach of the reporting obligation (Court of Justice of the European Union. Judgment of October 9, 2014. Case C-326/12)

German legislation relating to investments made through national and international investment funds establishes that for each distribution of income, with respect to an ownership interest, the investment company must meet certain obligations to communicate and publish certain information. German legislation also establishes that for cases where these obligations are breached, the taxation will be charged at a flat rate. The question referred for a preliminary ruling asked whether that legislation was a concealed restriction on the free movement of capital, especially bearing in mind that the obligation to pay tax at a flat rate mainly affects the income from nonresident funds which tend to breach the communication obligations.

The Court held that the principle of free movement of capital must be interpreted as precluding national legislation which provides that the failure by a nonresident investment fund to meet the obligations to communicate and publish certain information required by that legislation triggers a flat-rate taxation of the income which the taxpayer obtains from that investment fund, since that legislation does not allow the taxpayer to provide evidence or information to show the actual amount of that income, even though that provision is also established for resident funds.

5. Personal income tax.- Value of compensation in kind for the supply to employees of airplane tickets without seat reservation (Supreme Court. Judgment of October 16, 2014)

An airline supplied to its employees airplane tickets without seat reservation and valued them at their marginal cost. The inspectors considered that they should be valued at market value, that is, at the same price offered to the public for airplane tickets with seat reservation, for the purpose of calculating personal income tax withholdings.

In response, the company argued that:

(a) Tickets with and without seat reservation are not equivalent products.

(b) There is not, within the actual company or the market, a sale price offered to the public for airplane tickets without seat reservation.

The Supreme Court, acknowledging the lack of express reference in the law on how to value compensation in kind offered by the company to its employees in cases where the service is provided on different conditions from those offered to the general public, considered that due to the anti-abuse nature of the provision, it must be construed to mean that in such cases, the compensation in kind must be valued based on the view that the service provided by the company is basically the same as that provided to the general public.

This means that those tickets must be valued as closely to the "price offered to the public," never at the marginal cost of the ticket, given that the use of the ticket without seat reservation for the employee is exactly the same as that of a passenger who obtains a seat on an airplane at the last minute without having made a prior reservation and pays the price set at that moment.

6. Personal income tax.- Consolidation of legal title entails a new assignment of the assets to the economic activity (National Appellate Court. Judgment of June 4, 2014)

In this case, a woman was the usufructuary of certain properties used in a farming activity. After her death, her children, the naked owners of those properties, consolidated the absolute title and decided to transfer them. For personal income tax purposes, they calculated the capital gain they obtained according to the general rules applicable to assets not used in a business activity.

The TEAC considered that what had happened was a continuation by the naked owners of the activity carried out previously by the usufructuary and that, therefore, the transferred assets were assigned to the business activity, meaning that the abatement coefficients did not apply for calculating the capital gain on the transfer.

The National Appellate Court, however, ruled that the 3-year period established in the law for considering that an asset is assigned to a business activity must begin to be computed again after the legal title is consolidated, given that the naked owners can only take the decision of assigning those assets to the activity as from that time. The Chamber considered, therefore, that through the consolidation of legal title, there is a new assignment and not a consolidation of the assignment made by the usufructuary in the past.

7. Personal income tax.- Reduction for joint taxation does not apply where taxpayer lives with the other parent of their children in common (Castilla y León High Court. Judgment of May 23, 2014)

The High Court ruled that the reduction for joint taxation established for single-parent family units (those in which there is not a tie by marriage and which are formed by the mother or father with all the children who live with one or the other) where the taxpayer lives with the father or mother of the children which they had together.

In other words, that reduction cannot be applied in cases of de facto couples that live with their children in common, as article 84 of the Personal Income Tax Law expressly establishes that "*This reduction shall not apply where the taxpayer lives with the father or mother of any of the children forming part of the family unit*."

8. Refund of taxes contrary to Community law.- On the procedure for recovery of unlawful State aid (Supreme Court. Judgments of October 1 and 9, 2014)

The Supreme Court questioned in these judgments whether State aid held to be incompatible with the common market must be recovered following a specific procedure and whether, in any case, before adopting the relevant decision, the beneficiary of the aid, which is obliged to refund it, should be given a hearing.

The Court held as follows:

(a) There is not a "procedural" law of the European Union for the enforcement of its decisions. Therefore, it is for the domestic legislature to determine the procedures for the recovery of the aid.

(b) The transnational legal system imposes the obligation to adopt all the appropriate measures to ensure the enforcement of the Commission's decisions which require recovery of unlawful aid, while observing the particularities of the different proceedings established for that purpose by the member States.

In this regard, both Spanish domestic law and European Union law establish the right of all persons to be heard before an individual measure adversely affecting the person is adopted.

For that reason, the Supreme Court held (in its judgment of October 1) that the contested decisions were null and void due to having been adopted directly without any prior proceeding.

9. *VAT.- The wording of a provision in force in a fiscal year after that inspected must be applied if that new wording is supported by Community case law (National Appellate Court. Judgment of September 17, 2014)*

The tax authorities rejected the validity of the deduction of VAT not self-charged previously by the taxable person, since it resulted from an assessment issued by the tax authorities which gave rise, in turn, to the imposition of a penalty.

The Chamber considered that the inspectors' rejection of the right to the deduction in the case analyzed was unjustified, stating that its conclusions are supported not only by case law of the Court of Justice of the European Union regarding the right to the deduction, but also by the fact that the legislature has expressly recognized the need to adapt the wording of article 89.3 of the VAT Law to European Union legislation.

10. *Inheritance and gift tax.- A capital gain obtained exceptionally must not be taken into account to calculate the main source of income (Extremadura High Court. Judgment of June 24, 2014)*

The reduction for acquisition of the family business for inheritance and gift tax purposes is applicable where, among others, the decedent's main source of income derives from that family business. In the case analyzed, the decedent had obtained in the fiscal year prior to his death an extraordinary capital gain on the transfer of several assets, which meant that his main source of income in that year was not the income derived from the business activity which he had been carrying out.

The Chamber held that such capital gain must be deemed exceptional and not taken into account for purposes of applying that reduction in question; that, in a case in which, through the returns of preceding years, it had been evidenced that the income obtained from carrying out business activities was up to four times more than the rest of the decedent's income from work and business activities. As those were his ordinary sources of income, there was no reason to interpret that the decedent did not perform the business activity directly and habitually, meaning that the disputed reduction should apply.

11. Real estate tax.- It is not possible to contest the cadastral classification of a plot by contesting the real estate tax assessment (Cataluña High Court. Judgment of June 5, 2014)

The taxpayer contested the real estate tax assessment, contending that the property to which it referred was not developable and that, therefore, the tax rate that would apply would be that established for rural property, which is lower than that applied.

The Court, however, ruled that the consideration of a property as urban or rural land is the jurisdiction of the Cadaster and not of the Municipal Council or Court, which cannot give an opinion on this issue. Thus, it held that contesting the real estate tax assessment is not the appropriate procedure for contesting the cadastral classification of a plot and that cadastral management issues must be appealed and decided by the relevant economic-administrative bodies of the State.

12. Administrative proceeding.- Recognition of the "two shot" rule (Supreme Court. Judgments of September 15 and 29, and October 16, 2014)

The Court analyzed the possibility for the tax authorities to make a new assessment in cases where a prior tax assessment has been rendered null due to defects in the merits or material or substantive defects. Briefly, the text of the three judgments permits the conclusion that, according to the Supreme Court:

(a) Proceedings cannot be rolled back when an assessment is rendered null for reasons of merit or substantive reasons.

(b) That does not mean that the tax authorities cannot issue a new assessment to replace the one rendered null.

(c) However, this new assessment will be limited by the statute of limitations (taking into account the case law that rejects the tolling effects of decisions rendered null as a matter of law) and by the prohibition on incurring "reformatio in peius".

In any case, in the judgment of September 29, 2014, the Court recalled that the tax authorities' power to make a new assessment is not absolute, denying all effects to the assessment that commits the same error, that is, denying in this way a third opportunity to the tax authorities.

Moreover, the Court rejects the application of the "two shot" theory regarding penalty proceedings, in accordance with the double jeopardy principle.

13. Management proceeding.- On tax relevance in information requirements (Supreme Court. Judgments of October 20 and 23, 2014)

The Court analyzed the concept of "tax relevance" for purposes of the duty to collaborate with the tax authorities:

(a) In the judgment of October 23, 2014 (cassation appeal no. 593/2012), the Court specifically analyzed an information requirement issued to a bank with the aim of knowing the list of accounts which, in a specific fiscal year, had had an annual total amount from the sum of entries in the Credit side in an amount exceeding €3 million, specifying the taxpayer identification number of the declarant entity, customer account code and total amount of the sum of entries made to Credit.

The Supreme Court, based on previous judgments on very similar cases, held that *"tax relevance"* must be defined as *"the quality of facts or acts that can be useful to the tax authorities to verify whether or not certain persons meet the obligation established in art. 31.1 of the Constitution of contributing to sustain public expenditure according to their ability to pay and to be able to, otherwise, act accordingly, pursuant to the law."*

Regarding the reasoning behind the requirements, the Court ruled that the decision must contain sufficient reasoning so that the reasonable application of the law can be recognized in it, that is, the information requirement must be adapted to what is needed for the management and inspection of taxes.

Accordingly, the Court held that in the case analyzed, the reason for the information request was adequately explained given that it specified, among others, the core of affected taxpayers, the legal framework in which the obligation to collaborate with the information arose and the usefulness of the information, placed in relation to the inspectors' investigation work on certain bank accounts, through which the "tax relevance" had been evidenced and the requirements of reasoning and proportionality met, and the Court therefore confirmed the tax authorities' conduct.

(b) In the judgments dated October 20 and 23, 2014 (cassation appeals no. 1414/2012 and 2182/2012, respectively), the Court analyzed the definition of tax relevance in relation to a request to obtain information addressed to a real estate appraisal company.

For that purpose, within the definition of tax relevance, a distinction was made between:

- Data which, per se, have tax relevance, that quality being evident by their mere description. This would be the case of the balances of accounts at financial institutions or of cash transactions in banks with 500-euro bills, in respect of which the Supreme Court has concluded in different judgments relating to those transactions that the mere objective reference to the elements of information required and to the legal provisions justifying the requirement are sufficient.

- Data the tax relevance of which is not evident, meaning that in order to highlight that relevance, something more than the simple listing thereof and the reference to the provisions authorizing the inspectors to request them is necessary.

  Supreme Court case law on this issue is settled, establishing that (i) information requirements must be reasoned, (ii) they must meet the provision on itemization which the type of information requested requires and (iii) there must be specific and sufficient justification for the requirements.

In the cases analyzed, the Supreme Court affirmed, in relation to this latter type of data (indirect tax relevance), that a brief reference to the legal provisions and regulations on which the tax authorities' conduct is based or to a vague description of the data required in relation to real estate appraisals (which, unlike those concerning the transactions at banks, savings banks, credit cooperatives and institutions engaged in bank and credit transactions, are not in and of themselves and directly relevant for tax purposes) is not sufficient.

As the Court stated, the appraisal of real estate is not always and necessarily linked to a transaction that must have tax relevance now or at a later time. At times the appraisal of property is not requested by its owner and at others, it is not linked to a transaction with economic relevance and, where it is, the transaction might not have been completed.

14. Collection proceeding.- The enforced collection surcharge must be calculated on the proportional part of the debt the pertains to the secondarily liable party (National Appellate Court. Judgment of September 22, 2014)

One of the parties declared secondarily liable for a debt contested the enforced collection surcharge claimed from it, contending that one of the other secondarily liable parties had already paid the total debt, along with the surcharges and interest of the enforcement period.

The claim was rejected on the ground that the secondarily liable parties are liable for the debts of the principal debtor in the voluntary period and that if those debts are not paid in time, an enforced collection proceeding for the total debt must be initiated against each and every one of them individually. Therefore, as one of the liable parties paid the debt after the initiation of the enforcement period, the surcharges accrued for each one of them are claimable.

The National Appellate Court confirmed the foregoing view, insofar as it ruled that the surcharge is claimable, but it stated that the surcharge would have to be calculated not on the total amount of the debt subject to enforced collection, but on the debt for which the appellant is liable in proportion to the number of secondarily liable parties. The Court arrived at this view because it considered that the nature of secondary liability is several on a pro rata basis and that an action for contribution can be brought against the other secondarily liable parties. Therefore, the Chamber partially upheld the appeal, ordering the refund of the amount paid by the appellant in excess of the amount of the surcharge that corresponded to it, calculated on its proportional part of the debt.

15. Review proceeding.- Proof must be provided in the inspection (Supreme Court. Judgment of October 17, 2014)

In this judgment, the Court analyzed a long-standing issue about whether proof can be provided in the proceeding before an economic-administrative tribunal or judicial review court if that proof was not provided to the inspectors.

The view of the TEAC is that, according to article 112.1 of the Public Authorities and Common Administrative Procedure Law, the decision on appeals will not take into account facts, documents or submissions by the appellant if it did not provide them during the submissions phase when it could have done. However, the same Central Economic-Administrative Tribunal habitually defends that this rule must be applied with caution, according to the constitutional principle of the right to effective judicial protection. Due to that, in a decision dated January 23, 2014, the TEAC confined the application of that rule to proof which was specifically requested in the tax application proceeding and could have been provided but was not. However, the TEAC considered that there was a denial of due process rights where the appellant could only be aware of the proof that it must provide when it was notified of the contested decision with its full justification.

In general, this restriction on the right to provide proof has been viewed negatively. Among others, the Supreme Court, in a judgment dated June 20, 2012, permitted the proof of some expenses provided for the first time in the judicial jurisdiction and ordered that the case be returned to the tax inspectors for them to evaluate that proof.

However, the recent judgment of the Supreme Court dated October 17, 2014, takes a different direction. In this case, the Court analyzed a company's claim to have its corporate income tax base recalculated bearing in mind the correct value of its initial inventory when the tax authorities had adjusted that of the final inventory of a year. The Supreme Court highlighted that this claim had been made for the first time before the economic-administrative tribunal and that, therefore, the proof provided to support that claim did not reinforce an argument put

forth previously but rather entailed a new issue not brought forth to the inspectors. The Supreme Court stated that, due to that, the proof could not be admitted, because the appellant cannot claim, at court level, a reconstruction of its situation and a new regularization, when its passivity caused the regularization already carried out by the tax inspectors.

II. Decisions and rulings

1. *Corporate income tax.– Revenues are not recognized for the compensation received in provisional enforcement of a judgment that has been contested by the defendant (Directorate-General of Taxes. Ruling V2395-14, of September 11, 2014)*

A company was entitled to receive compensation from another company pursuant to the judgment of a court of first instance, against which the defendant filed an appeal. However, the possibility of requesting the provisional enforcement of the judgment was raised.

According to the Directorate-General of Taxes (DGT):

(a) The revenue derived from the compensation will accrue in the tax period in which the judgment becomes final, which will not occur until a decision is issued on the appeal.

(b) If the provisional enforcement is requested of the judgment handed down at first instance, because it has not become final, the collection of the compensation, provisionally, will not be recognized as revenue but as a liability, thus not having any impact on the tax base of the period.

(c) When the judgment becomes final, if it is favorable, extraordinary revenue will be recognized for the amount of the compensation recognized by the court. Moreover, if the decision at second instance is unfavorable, the liability account will be derecognized with a credit to cash, and that return of the compensation will not have any impact on the income statement or on the tax base of the period.

2. *Personal income tax.– Deductibility of contributions to the social security system of other States of the European Union (Directorate-General of Taxes. Ruling V2536-14, of September 30, 2014)*

An employee with tax residence in Spain plans to be transferred to another country of the European Union where he will make contributions to the social security for the work performed there.

The DGT ruled that if, according to the legislation applicable in this regard, the social security legislation applicable to the worker is that of the other member State where he must make contributions due to the performance of his work as an employee in that other State, those contributions will be deemed a deductible expense for determining the net salary income subject to personal income tax.

The foregoing conclusion is not altered by the fact that the salary income might be exempt, in full or in part, by application of the exemption established in article 7.p) of the Personal Income Tax Law for the work carried out abroad.

3. Personal income tax.- Billing by professionals or entertainers to their company must coincide with that of the company to third parties minus the necessary expenses for performing the activity (Central Economic-Administrative Tribunal. Decision of September 11, 2014)

A journalist provided services to a company of which she was a shareholder and also sole director, engaging basically in producing audiovisual programs (specifically, the activity carried out was the participation by the journalist in audiovisual programs or advertising campaigns). This activity was carried out directly by that company (company X) or by another company owned by the former (company Y). The inspectors observed that the journalist's remuneration was much lower that the billing by these companies to third parties, all during fiscal years 2006 to 2008.

The journalist argued that her remuneration complied with market conditions and that the companies had to have a profit because they had material and human resources.

The TEAC recalled, firstly, how the legislation containing the rules for valuing this type of activities had changed over the years, stating that:

(a) The special regulation of this type of transactions arose when tax transparency still existed for professionals' companies, thereby reinforcing the general rules on related-party transactions and imposing on the taxpayers themselves the obligation to value their transactions for tax purposes at their normal market value.

(b) The successive Personal Income Tax Laws have contained references to corporate income tax legislation for valuing related-party transactions. This corporate income tax legislation has evolved, such that up to January 1, 1996, it required related parties to value transactions at the prices that would be agreed between independent parties. From January 1, 1996, it established unrestricted valuation, authorizing the tax authorities to value the transactions at market value when the value agreed by the parties gave rise to a reduction or deferral in the overall taxation in Spain. Lastly, since December 1, 2006, the law once again required it to be the taxpayers who apply market values in their transactions.

(c) The general reference by the Personal Income Tax Law to the Corporate Income Tax Law, however, was disrupted in 1999 (with Law 40/1998), establishing a specific provision for the case of economic activities or the performance of personal work by individuals with the company with which they are linked. In these cases, the taxpayer was specifically required to value these transactions at market value (even though that was not the rule in the corporate income tax legislation). Subsequently, starting on January 1, 2003, an irrebuttable presumption was established, according to which it was understood that the value agreed between related parties was the market value if 50% of the company's income derived from the pursuit of professional activities and provided that the entity had human and material resources to carry out its activities. Subsequently, from January 1, 2007 (with the new Law 35/2006), this specific rule disappeared and the law returned to the rule that imposed on taxpayers the obligation to apply market prices in their transactions with related parties.

Lastly, starting with the new article 16.6 of the Corporate Income Tax Regulations, in force since November 19, 2008, a new presumption was introduced for this type of transactions, according to which, the taxpayer can consider that the agreed value is the market value in the case of provisions of services by professional partners to related entities, as long as certain requirements are met (among others, they must be enterprises of a reduced size that have appropriate human and material resources).

Bearing in mind these progressive changes in the legislation, the TEAC ruled that in 2006, the first of the presumptions mentioned applied and that from November 19, 2008 until December 31 of that year, the second presumption applied; while in 2007 and up to November 19, 2009, there was a general obligation to value transactions at market values.

For the first and the last of the periods, however, the TEAC recalled that the presumptions mentioned only apply insofar as, among others, the entities have sufficient human and material resources which are suitable to their activity. In this regard, the TEAC stated that:

(a) An activity such as that analyzed needs a single resource, which is none other than the actual professional/entertainer, because it is an activity that is highly personal in nature. In fact, the third parties engaged the company due to the fact that the services were provided by the professional.

(b) In this regard, any other human or material resource at the company must be deemed unnecessary for the activity, meaning that the companies (X and Y) contribute nothing to the activity, or, in other words, they add no value to the services actually provided by the shareholder and director.

(c) The fact that for the lease activity, it suffices for there to be an employee and premises does not mean that that is the case for other activities and, in any case, the human resources must always be understood to exclude the actual professional, given that the latter's services have a direct impact on the pursuit of the professional activity by the company and are always present (otherwise, the requirement on which the application of the presumptions is conditional would be rendered meaningless).

Having stated the foregoing, the TEAC held that in all of the fiscal years analyzed, the related-party transactions (the remuneration of the professional) should be valued at market value, either because none of the aforementioned legal presumptions existed in those years or because they did not apply due to the absence of material and human resources. This market valuation, according to the TEAC, must coincide with the income obtained by company X (directly or through company Y) minus the expenses necessary to carry out the activity.

Lastly, the Tribunal confirmed that the penalty for the professional's failure to pay personal income tax must be calculated without taking into account what was already paid by the companies for their corporate income tax.

4. Personal income tax.– Tax treatment of severance pay for individual dismissals (Directorate-General of Taxes. Rulings V2273-14 and V2275-14, of September 4, 2014)

Royal Decree-Law 3/2012 amended the wording of article 7.e) of the Personal Income Tax Law which regulates severance pay for dismissal, eliminating the paragraph that referred to severance pay where the employment contract is terminated before the conciliation hearing (known as "express dismissal").

In this decision, the DGT analyzed two cases of individual dismissal, one on objective grounds and the other on disciplinary grounds but with the company's recognition that the dismissal was unjustified in this second case, and there was no conciliation hearing before the Mediation, Arbitration and Conciliation Service or the competent court in either case. The DGT's conclusions in relation to the exemption for the severance pay were as follows:

(a) In unjustified dismissals, in order to apply the exemption, the recognition of the unjustified nature of the dismissal must take place at the conciliation hearing before the Mediation, Arbitration and Conciliation Service or through a court decision (DGT V2275-14).

(b) In the case of termination of the employment relationship on objective grounds under article 52.c) of the Workers' Statute (individual objective dismissal), the severance pay will be exempt up to the limit established for an unjustified dismissal, and administrative or judicial conciliation will not be necessary in this case (DGT V2273-14).

5. *Personal income tax.- Application of the reduction for multi-year income to the compensation received pursuant to agreement to access partial retirement (Directorate-General of Taxes. Ruling V2250-14, of September 3, 2014)*

The DGT analyzed the case of a worker that terminated his employment relationship in the context of a collective layoff proceeding through a pre-retirement agreement, according to which he would be entitled to receive certain monthly amounts from the termination date of the employment relationship until the retirement date. Afterwards, the company and the worker reached an agreement whereby the worker would access partial retirement, receiving in exchange an indemnity from the company for items relating to the period running from the envisaged retirement date to his 65th birthday, quantified as the difference between the amount of his official retirement pension from the social security authorities and the guarantee established in the pre-retirement agreement.

The DGT ruled that this indemnity entails for the worker an item of compensation for the drop in income resulting from his accessing partial retirement, which falls within the category of "amounts paid in compensation or reparation of salary supplements, pensions or annuities of an indefinite duration" and, thus, it would be subject to the 40% reduction established for income obtained on a notably irregular basis over time, as long as it is recognized in a single tax period.

6. *Value added tax/Transfer and stamp tax.- Status of VAT taxable person not acquired in case of transfer of rural property included in development plan, in respect of which physical transformation works have not yet been carried out on the land (Central Economic-Administrative Tribunal. Decision of October 23, 2014)*

The disputed case derived from a sale and purchase of real estate in which the sellers transferred an indivisible stake in three rural properties included in the Municipal Master Plan. The transaction was classified in the actual public deed as a supply of buildable land, subject to and not exempt from VAT. Subsequently, a limited inspection was initiated at the appellant and a provisional assessment proposal issued, classifying the transfer as not subject to VAT and, thus, subject to transfer tax. At first instance, the Castilla-La Mancha Regional Economic-Administrative Tribunal rejected the claim, against which the taxpayer appealed before the TEAC.

The TEAC confirmed the Regional Tribunal's decision, modifying its previous position set forth in a decision of June 20, 2013, by applying the Supreme Court case law contained in a judgment dated March 13, 2014. According to that case law, in the case of transfers of land that are not undergoing development, as the material transformation works on the land have not commenced, the owner of the land will not have acquired the status of trader, because it will not have borne the cost of physically transforming the land (it not being sufficient for this purpose to have incurred administrative expenses).

7. Transfer and stamp tax.- Recovery of ownership of an asset as a consequence of court-ordered termination of a contract (Directorate-General of Taxes. Ruling V2257-14, of September 3, 2014)

The DGT analyzed the tax treatment applicable to the recovery of ownership of real estate previously transferred in a public deed with payment deferral, through the court-ordered termination of the sale and purchase agreement due to breach of the payment obligation by the purchaser.

In this case, the fulfilment of an express resolutory condition does not imply a new transfer in favor of the seller but rather the recovery by it of the ownership originally transferred, and therefore transfer tax under the "transfers for a consideration" is not triggered, although the transaction could be subject to stamp tax, where the requirements established in the law are met for that tax to be chargeable (which are, among others, a public deed and an amount or thing capable of being valued).

8. Administrative proceeding.- A refund application tolls the limitations period on the right to obtain the relevant refund even if the refund proceeding chosen is not the appropriate one (Central Economic-Administrative Tribunal. Decision of September 16, 2014)

The taxpayer filed a VAT refund application through the special procedure for nonestablished taxable persons in June 2004. Almost three years later, the tax authorities issued a decision rejecting the refund on the ground that it should have been requested through the refund procedure established under the general VAT scheme. It turned out that because of the time elapsed between the refund application and the decision rejecting it, the VAT borne under the general scheme in some fiscal years could no longer be recovered.

The TEAC held that there is no statute-barring in a case such as this, because the limitations period would always be deemed tolled by any legally valid act of the taxpayer seeking the refund of amounts incorrectly paid over or by any act of the tax authorities recognizing their existence. In short, in this case, the application for a refund of amounts borne under the special scheme for nonestablished taxable persons tolled the limitations period on the right to apply for a refund of VAT borne under the general scheme.

9. Penalty proceeding.- The 25% reduction does not apply where the taxpayer requests a deferral or payment in installments of the penalty with offer of guarantee other than a bank guarantee or surety bond certificate, even if he pays within the deferral or installment payment period granted (Central Economic-Administrative Tribunal. Decision of September 30, 2014)

The tax authorities had imposed a penalty for tax infringement. Within the voluntary period, the taxpayer requested a deferral/payment in installments with guarantee other than a bank guarantee or surety bond certificate. As the guarantee given was not one of those mentioned,

the taxpayer was required to pay over the amount of the 25% reduction in penalty, which had been granted previously (which reduction, according to the General Taxation Law, is granted when the penalty is not appealed and is paid on time).

The TEAC ruled that the reduction in penalty could only be maintained in a case of deferral or payment in installments if the guarantee given is a bank guarantee or surety bond certificate, that is, the guarantees which are suitable for granting an automatic stay of the debt (or, as appropriate, for granting an automatic stay by reason of the amount, in the case of debts below €18,000). However, where guarantees other than those mentioned are provided and the debt is above €18,000, the 25% reduction will be forfeited due to the deferral or payment in installments.

10. Penalty proceeding.- The Chief Inspector has the authority to impose a penalty even though he modifies the penalty proposal made by the inspectors, insofar as that modification does not involve any act of inspection or, thus, modification of the proof (Central Economic-Administrative Tribunal. Decision of September 16, 2014)

The Chief Inspector had modified the proposed penalty by raising the scale of the penalty from minor to serious. The taxpayer appealed before the Cataluña Regional Economic-Administrative Tribunal on the ground that it breached the prohibition for the inspection activity and the decision on the penalty to be handled by the same person. The Regional Economic-Administrative Tribunal annulled the penalty decision considering that it was not lawful for this reason. An extraordinary appeal was filed against that decision for a definitive ruling on a point of law.

The TEAC upheld the appeal, holding that in cases where the Chief Inspector disagrees with the prior inspection proceedings, he must annul the proposal in order for the inspection phase to be carried out again before the competent body. However, when the penalty proposal is not annulled but merely modified, he can modify the proposal himself and issue the penalty decision.

This is possible when the modification of the proposal has the following scope: (i) where it considers sanctionable conduct that was not considered sanctionable in the inspection phase, (ii) where the definition of sanctionable conduct is modified, or (iii) where, as in the present case, the scale of the infringement is changed. The TEAC referred to several National Appellate Court judgments to justify its interpretation.

11. Collection proceeding.- For ex officio set-off to be possible, the enforcement period must have commenced and the order initiating enforced collection must have been notified (Central Economic-Administrative Tribunal. Decision of October 30, 2014)

In the context of a collection proceeding, the enforcement period had commenced but the order initiating the enforced collection had not been notified. Against this backdrop, a decision was issued approving the *ex officio* set-off of the debt, which included the 5% enforcement surcharge, against the claim previously recognized in the taxpayer's favor. The entity filed an economic-administrative claim against this decision with the Andalucía TEAR, which recognized the nullity of the set-off decision given that it was not evidenced that the debt fell within the enforcement period, as there was no record of any notification of the order initiating the enforced collection. An appeal for a definitive ruling on a point of law was filed against this decision.

The TEAC concluded that the enforcement period commenced on the day following the end of the voluntary payment period. A different matter was whether the enforced collection proceeding had been commenced by way of the order initiating such enforced collection notified to the taxpayer. Having clarified this, the TEAC reiterated the position it had taken in prior decisions (RG.5961/2011 and 2043-09-50), concluding that the order initiating the enforced collection need not be notified to be able to proceed with an e*x officio* set-off of debt provided that the voluntary payment period has elapsed. Moreover, once the enforcement period has commenced, the surcharges from the enforcement period and the late-payment interest will have accrued, so the set-off will extend to these items as well.

III. Legislation

1. Changes introduced in the scope of the various information returns

The Official State Gazette of November 26, 2014 has published Order HAP/2201/2014, of November 21, 2014, amending Order EHA/3021/2007, of October 11, 2007, approving form 182, information returns for gifts, donations and contributions received and dispositions effected, as well as the physical and logical designs for replacing the inside sheets of the form with computer-readable media and establishing the conditions and the procedure for its electronic filing online, and amending return forms 194, 196, 198, 215 and 345; simplifying the reporting requirements established in relation to the cross-border marketing of shares and units of Spanish collective investment undertakings and amending other tax provisions.

First of all, the Order amends form 182, information return for gifts, donations and contributions received and dispositions effected, in order to more suitably identify cases of expenditure of money and other fungible assets included in the protected assets of disabled persons and carried out in the tax period of the contribution and in the following four periods which must not produce the tax effects derived from a disposition.

In addition, the changes introduced by Law 16/2013 in the Collective Investment Undertakings Law and Royal Decree 960/2013, of December 5, 2013, have simplified the reporting requirements established in relation to the marketing abroad of Spanish collective investment undertakings. These changes have also led, in turn, to the amendment and adaptation of Order EHA/1674/2006, of May 24, 2006 and Order EHA/3290/2008, of November 6, 2008 regulating forms 216 and 296 (nonresidents).

These adaptations are made with respect to the requirements to supply information to the tax authorities in the sense of (i) releasing marketers resident in a country with which Spain has signed a tax treaty with an exchange of information provision from including in the itemized lists that they must submit annually to residents in the same country of residence of the marketer under certain conditions and (ii) releasing nonresident marketers that are not required to submit itemized lists from the requirement to obtain a taxpayer identification number.

Lastly, as regards information returns, the identification code of forms 038, 180, 188, 189, 192, 194, 195, 198, 199 and 480 is modified so that its first three digits coincide with the number assigned to the form itself.

The provisions of the Order will enter into force on November 27 and will apply for the first time for the filing of information returns the filing period of which commences on or after January 1, 2015, in relation to the information for fiscal year 2014.

2. *Approval of form 410, prepayments of the tax on deposits at credit institutions, and changes to form 190, annual summary of personal income tax withholdings and prepayments*

The Official State Gazette of November 24, 2014 has published Order HAP/2178/2014, of November 18, 2014, approving form 410, prepayments of the tax on deposits at credit institutions, and establishing the conditions and procedure for filing it.

Also modified is Order EHA/3127/2009, of November 10, 2009, approving form 190 for the annual summary return of personal income tax withholdings and prepayments on salary and economic activities income, prizes and certain capital gains and attributions of income, and amending other tax provisions.

With respect to **form 410**, it is worth noting that from the 2014 tax period onward, taxpayers of the tax on deposits at credit institutions, besides filing the relevant self-assessment for the tax, will be required to make a prepayment of the tax on form 410 during the month of July (between 1st and 31st) of each year and for the period in progress, although for the 2014 tax period the Order establishes a special filing period from December 1 to 31 of the same year (December 1 and 23 for taxpayers who elect to pay the tax debt by direct debit).

With respect to **form 190**, it has been adapted:

(a) to envisage cases in which the rate of 15% applies for withholdings and prepayments on income derived from professional activities, where the value of gross income from such activities relating to the immediately preceding year is lower than €15,000 and represents more than 75% of the sum of the gross income from economic activities and from salary obtained by the taxpayer in that year;

(b) to be able to enter contributions to the general social security regime for workers treated as employees, where compensation is paid to board members and directors who do not have control over a company and the discharge of their office entails performing functions relating to the management and administration of the company for compensation.

The provisions of the Order will enter into force on November 25, 2014 and will apply for the first time, with respect to form 190, for the filing of the annual summary return for withholdings and prepayments for fiscal year 2014.

3. *Changes in the area of registration and management of powers of attorney, successions and legal representation of minors and disabled persons for completing formalities and steps online with the Tax Agency*

The Official State Gazette of October 30, 2014 has published the Decision of October 22, 2014, of the Directorate-General of the State Tax Agency, amending the Decision of May 18, 2010, concerning the registration and management of powers of attorney and the registration and management of successions and legal representation of minors and disabled persons for completing formalities and steps online with the Tax Agency.

The decision expands the cases of inclusion in the register of successors in cases where the succession is detected by the tax authorities by querying a public registry or in light of the documents that have been provided to it in any tax application procedure and which, according to the civil or commercial law, evidence the death and succession of the individual or the termination and succession of the legal entity or entity lacking separate legal personality.

In addition, the request for the opinion of the Legal Service is replaced in all cases with the possibility of requesting such report in cases where there are reasonable doubts on the part of the body that makes the inclusion in the register.

The decision has applied since October 31, 2014.

IV. Others

1. The Tax Agency launches a new VAT management system

On October 20, 2014, the Tax Agency issued a press release in which it announced the launch of a new VAT management system based on information on commercial transactions in real time.

The new Immediate Supply of Information (I.S.I.) system will require taxable persons to send the detail of the book of invoices that must be recorded in the "VAT books", which will entail keeping the VAT books on the Tax Agency's website. The information to be sent will include the essential data from the invoice issued or received and must be completed within four days after an invoice is issued or received (thereby eliminating the possibility of making summary entries, including in the case of receipts).

The press release notes that the advantages of the system include: (i) facilitating voluntary compliance through the creation of tax data for VAT purposes that may be consulted at any time and used to file returns, (ii) reducing indirect burdens by eliminating the obligation to file information returns corresponding to forms 347 (third-party information), 340 (transactions in VAT books) and 390 (annual VAT recapitulative statement), (iii) granting a longer period for filing VAT returns and (iv) making verifications more selective and faster because information on transactions is practically obtained in real time.

This new "Immediate Supply of Information" ("ISI") is set to take effect on January 1, 2017 and will be mandatory for large companies, corporate groups for VAT purposes and other taxpayers registered for the monthly VAT refund scheme ('Redeme'), although other taxpayers may elect to apply it voluntarily.

2. The draft personal income tax regulations are made public for observations

The Draft Royal Decree amending the Personal Income Tax Regulations, approved by Royal Decree 439/2007, of March 30, 2007, on prepayments and allowances for large families or disabled persons under care, was made public on October 22, 2014.

These draft regulations seek (i) to adapt the personal income tax regulations on prepayments to the amendments made to the Personal Income Tax Law, (ii) to flesh out both the manner in which the amount of new allowances for large families and disabled persons under care is calculated, and the requirements and procedure for applying to the State Tax Agency for the early payment of those allowances, and (iii) to simplify the manner in which tax prepayments are calculated and to establish a reduction in their amount for self-employed workers.

The public consultation phase of the draft regulations ended on October 31.

More information:

Eduardo Abad
Partner in charge of Tax Law Department
eduardo.abad@garrigues.com
T +34 91 514 52 00

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