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NEW TAX LEGISLATION IN ROYAL DECREE-LAW 20/2012

Royal Decree-Law 20/2012, of July 13, 2012 on measures to ensure budgetary stability and on encouraging competitiveness, was published in the Official State Gazette on July 14, 2012. It contains new tax legislation on a range of taxes which, in some cases, amends or expands on the reforms introduced by Royal Decree-law 9/2011, Royal Decree-law 20/2011 and Royal Decree-law 12/2012, all targeted at reducing the budget deficit.

VAT rates have been changed to bring them closer to those in force in the European Union. Coming into effect on September 1, the standard 18% rate will go up to 21% and the 8% reduced rate, to 10%. The new legislation has also changed the tax rate from the reduced rate to the standard rate for certain products and services.

Changes to Spanish personal income tax include the disappearance of tax relief for acquisition of the taxpayer's principal residence, available for taxpayers who acquired their principal residence before January 20, 2006, which will come into effect immediately in 2012. Additionally, until December 31, 2013, the fixed rate for the withholdings or prepayments applying to certain earnings has been increased from 15% to 21% and has been set at 19% from that date onwards.

The corporate income tax measures once again primarily affect large companies, which have temporarily had restrictions placed on their ability to use tax loss carryforwards and have had their payments in account increased. For all taxpayers, the maximum annual limit for credits in respect of the amortization of intangible assets with an indefinite useful life has been reduced, as had already been brought into effect in relation to the goodwill acquired with a business. Some clarifications and explanations have also been provided in relation to the rules on deductible financial expenses, which add insurance firms to the list of enterprises not eligible to deduct these expenses.

Until November 30, 2012 only, there will be a new special 10% tax on foreign-source income, similar to the 8% tax on this type of income introduced by Royal Decree-Law 12/2012, but with fewer requirements for its application.

Lastly, various changes have been made to the taxation of tobacco products, with the intention to increase tax revenues and as an instrument serving the aims of health policy.

All these measures are described below.

1. VAT

1.1 Performance of construction work on real estate: taxable event

The VAT law characterizes as a supply of goods the performance of construction work having as its purpose the construction or renovation of a structure, where the person performing the work contributes materials with a cost exceeding 33% of the tax base. The percentage was raised from 20% to 33% by Royal Decree-law 6/2010, of April 9, 2010. Royal Decree-law 20/2012 has now pushed it up to 40% for transactions on which VAT becomes chargeable on or after September 1, 2012.

1.2 Standard and reduced rate

With effect from September 1, 2012, the standard and reduced VAT rates have been raised to bring them closer to those in force in the European Union:

- The standard rate will go up from 18% to 21%.
- The reduced rate will go up from 8% to 10%.

On top of this, the following supplies of goods, intra-Community acquisitions and imports and supplies of services that were previously taxed at the reduced rate of 8% will now be taxed at the standard rate of 21%:

- Ornamental fresh flowers and live plants.
- Mixed services combining hospitality, shows, discotheques, theater halls, barbeques or other similar services (which is a return to the exclusion of these services from the reduced rate repealed by Law 41/1994, of December 30, 1994).
- Tickets for the theater, circus, shows and bullfights that qualified for the reduced rate, amusement parks and fair attractions, concerts, zoos, cinema theaters and exhibitions, and other cultural events, while the reduced rate will continue to apply only to tickets to enter libraries, archives and documentation centers and museums, art galleries and art museums.
- The services provided to individuals who play a sport or are engaged in physical education which are not exempt.
- The services provided by actors, entertainers, directors and technicians, who are individuals, to the producers of cinematographic films that can be shown at theater halls and to the organizers of theatrical and musical works.
- Funeral services provided by funeral directors and cemeteries, and the supplies of goods related to those services made to their recipients.

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- Health, dental and thermal treatment services that are not eligible for the exemption under article 20 of Law 37/1992.

- Hairdressing services, including, where applicable, any related services authorized in caption 972.1 of the rates for the tax on economic activities ("hairdressing services for ladies and gentlemen").

- The supply and receipt of digital radiobroadcasting services and digital television services.

- Imports and supplies of works of art. In connection with this change of tax rate for works of art, the scope of application of the special system set out in article 135 et seq. of the VAT Law has also been changed, to include a transitional provision in order for taxable persons who resell used goods or personal property which are considered to be art, antiques or collectible items to be able to take that special treatment for supplies of those goods that were acquired at the reduced VAT rate.

In addition, the rate has gone up from 4% to 21% for supplies, intra-Community acquisitions or imports of objects which due to their characteristics can only be used as materials for schools, whereas the 4% rate has been kept for albums, music scores, maps and drawing notebooks.

It must be underlined that the new legislation expressly does not repeal transitional provision four of Law 37/1992, added by Royal Decree-Law 9/2011 and extended until December 31, 2012 by Royal Decree-Law 20/2011 applying the super-reduced VAT rate (of 4%) to supplies of dwellings, including the parking spaces transferred with them, subject to a ceiling of two units and ancillary premises situated in them. It would not seem therefore that the intention is to eliminate this 4% rate until December 31, 2012 and apply the 10% rate only from that date onwards.

As a result of these amendments, changes have been made to the applicable rates on:

- Payments under the special treatment for agriculture, livestock and fishing, which have been increased:

  - From 10% to 12%, on supplies of natural products obtained by agricultural or forestry farm operators and on ancillary services to those farms.

  - From 8.5% to 10.5% on supplies of natural products obtained on livestock or fish farms and on ancillary services to those farms.

- The rates under the special compensatory charge scheme have been increased:

  - The general 4% charge has been increased to 5.2%.

  - The charge for goods qualifying for the reduced VAT rate has been increased from 1% to 1.4%.

2. CORPORATE INCOME TAX

2.1 Borrowing costs. Restriction on deductible borrowing costs

Royal Decree-Law 12/2012 introduced a general restriction on deductible net borrowing costs. Briefly, deductible financial expenses were restricted to 30% of the operating income for the fiscal year (with the ability, subject to certain rules, to deduct any excess over and above that limit in the following years) while allowing companies to deduct in all cases financial expenses in the year up to 1 million euros.

Certain features of that restriction have now been amended, to come into effect for tax periods started on or after January 1, 2012:

- It has been clarified that the minimum limit of 1 million euros will be applied in proportion to the length of the tax period and therefore for tax periods with a length of less than one year that limit will be weighted by reference to the proportion the tax period bears to a year.

- The enterprises to which the restriction applies have been expanded to include enterprises that are not part of a business group within the meaning of article 42 of the Commercial Code. Until now, the restriction only applied to those enterprises in certain cases. The restriction will therefore now apply to all enterprises subject to corporate income tax regardless of whether or not they belong to a business group.

- The exception for financial institutions has been broadened and therefore, under the new wording, also includes insurance firms, not only credit institutions.

  Where the credit institutions or insurance firms are part of a consolidated tax group with other enterprises that are not credit institutions or insurance firms, the restriction on deductible borrowing costs will be calculated by reference to the operating income and net borrowing costs of those other enterprises.

  The enterprises that will be treated as credit institutions for these purposes will be any enterprises whose voting rights are held directly or indirectly or wholly by those institutions and their only activity consists of issuing and placing on the market financial instruments to shore up the regulatory capital and the financing activities of those institutions.

- The restriction will not apply in the tax period in which the enterprise is dissolved, except in the followings scenarios:

  - Where the dissolution results from a restructuring transaction for which the corporate income tax neutrality treatment was taken.

  - Where it results from a transaction performed within a consolidated tax group and the dissolved entity has financial expenses that remained to be deducted when it became part of the group.

2.2 Payments in account

In recent years, the rules on payments in account for enterprises that use the "tax base method" of calculation have been amended a number of times to bring forward the collection of corporate income tax revenues. The biggest changes were made in the following pieces of legislation:

- Royal Decree-Law 9/2011 increased the percentage to be used to calculate payments in account, to amount, generally, to 21%, 24% or 27% depending on the net revenues of the enterprise subject to the payments.

- Royal Decree-Law 12/2012 set out a "minimum payment in account" calculated by applying a standard rate of 8% of the positive income figure per the accounts.

In further additions to these amendments, Royal Decree-Law 20/2012 has made changes to the three elements used to determine the amount to be paid over (the payment in account base, the payment in account percentage, and the minimum amount for the payment in account) which will affect the second and third payments in account in 2012 and the three payments in account in 2013:

- To determine the payment in account base of enterprises that apply the "tax base method," those enterprises must include in their tax base for the period for which the payment is being calculated 25% of the amount of the dividends and income earned in the period that are eligible for the international double taxation exemption under article 21 of the Revised Corporate Income Tax Law.

  In other words, the exemption, only for the purposes of calculating the payment, has been reduced from 100% to 75%.

- The percentage to be applied to the tax base to determine the payment has been increased for enterprises subject to corporate income tax whose turnovers are greater than 6,010,121.04 euros in the twelve months prior to the date on which the tax periods start in 2012 or 2013. The new percentage will be:

  - Five-sevenths of the tax rate, rounded down, where in those twelve months the entity's net revenues are below 10 million.

    For enterprises taxed at the standard rate, the percentage for calculating the payment in account will therefore remain unchanged, at 21%. This percentage also applies to enterprises whose turnovers do not exceed 6,010,121.04 euros.

  - Fifteen-twentieths of the tax rate, rounded up, where in those twelve months the net revenues are between 10 million euros and 20 million euros.

    For enterprises taxed at the standard rate, the percentage for calculating the payment in account will go up, therefore, to 23%.

  - Seventeen-twentieths of the tax rate, rounded up, where in those twelve months the net revenues are between 20 million euros and 60 million euros.

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For enterprises taxed at the standard rate, the percentage for calculating the payment in account will go up, therefore, to 26%.

- Nineteen-twentieths of the tax rate, rounded up, where in those twelve months the net revenues are at least 60 million euros.

  For enterprises that are taxed at the standard rate, the percentage used to calculate the payment in account will go up, therefore, to 29%.

In short, the percentage for calculating payments in account has been increased for enterprises with net revenues above 10 million euros (where they are taxed at the standard rate of 30%, they will have a two-point increase in payments in account).

- The new legislation has increased and amended the minimum amount for payments in account applying to enterprises subject to corporate income tax whose net revenues in the twelve months preceding the date on which the tax periods start in 2012 or 2013 are at least 20 million euros:

  - The base for the minimum amount for the payment will be calculated by reference to the entity's income figure for accounting purposes, and the option to reduce it with tax loss carryfowards has been eliminated.

  - The percentage for the minimum amount for the payment has been raised from 8% to 12%. In the case of enterprises where at least 85% of their revenues relate to income resulting from applying the exemptions under article 21 and article 22 of the Revised Corporate Income Tax Law or the tax credit under article 30.2 of this same law (double taxation exemptions and tax credits), the percentage has been raised from 4% to 6%.

  - No deductions in respect of reductions or withholdings can be made from the figure calculated as that percentage of the base. It appears, however, although the legislation is not clear, that payments in account made earlier for the same tax period can be deducted. This seems to be the interpretation that may be inferred from the preamble to the legislation we are summarizing, although not from the actual wording of its provisions, according to which it appears that the previous payments in account will not be deducted from the result of calculating the minimum amount for the payment in account, but from the calculation base (the income figure for the period for accounting purposes), which would distort the mechanics for calculating the payment in account.

2.3 Offset of tax loss carryfoward

For tax periods between 2011 and 2013, Royal Decree-law 9/2011 placed a ceiling on the tax loss carryfowards that could be offset by large enterprises with revenues above €20 million in the twelve months preceding the start of the tax period.

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Royal Decree-law 20/2012 places even further restrictions on the tax loss carryforwards that can be offset in tax periods starting in 2012 or 2013, as follows:

- If the entity's net revenues in those twelve months are between €20 million and €60 million, the tax losses that may be offset have been capped at 50% of the tax base prior to offset (that cap was 75% before Royal Decree-law 20/2012).

- If the entity's net revenues in those twelve months are at least €60 million, the tax losses that may be offset have been capped at 25% of the tax base prior to offset (that cap was 50% before Royal Decree-law 20/2012).

2.4 Tax amortization of goodwill and intangible assets with an indefinite useful life

Royal Decree-law 12/2012 established, for tax periods starting in 2012 and 2013, that the tax credit for goodwill derived from acquisitions of businesses, under article 12.6 of the Revised Corporate Income Tax Law, would be subject to a maximum annual limit of 1% (as opposed to the 5% previously in force). Under the new royal decree-law, that reduced limit will not apply to personal income taxpayers whose revenues in the immediately preceding tax period are below €10 million.

Moreover, in keeping with that measure, Royal Decree-law 20/2012 has now brought down, for tax periods starting in 2012 and 2013, the maximum limit on the tax deductibility of intangible assets with an indefinite useful life as mentioned in article 12.7 of the Revised Corporate Income Tax Law, from 10% to 2% (reduced by half). This reduction to the maximum limit will not apply either to personal income taxpayers whose revenues in the preceding tax period are below €10 million.

2.5 New special tax on foreign-source dividends and income deriving from the transfer of nonresident entities

Article 21 of the Revised Corporate Income Tax Law sets out a number of requirements for applying the exemption for foreign source dividends and capital gains derived from the transfer of foreign entities.

Royal Decree-law 12/2012 established a special tax of 8%, applied voluntarily on foreign-source income, targeted at enabling the repatriation of dividends or income on the transfer of shares in nonresident entities which, despite meeting some of the requirements established in that article 21 (5% holding owned uninterruptedly for a year and income deriving from the conduct of business activities abroad) did not meet the requirement of having been subject to a foreign tax identical or similar to Spanish corporate income tax.

A new special tax has now been created, for foreign-source income which cannot benefit from the exemption or from the special 8% tax because not all of the requirements established in the law are met. The new tax rate (which does not replace but rather supplements the previous one) is 10%, and the only requirement that must be met is a minimum 5% holding owned uninterruptedly for at least a year.

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The rules applicable to the new special tax are as follows:

- The taxpayer is allowed to elect to apply the general corporate income tax rules to qualifying income or, alternatively, not to include that income in the tax base and to apply this special tax to it.

- The expense for accounting purposes in respect of the special tax will not be deductible for corporate income tax purposes.

- The special tax may be applied to the dividends or shares in income of entities not resident in Spain which are payable up to November 30, 2012, provided that the Spanish entity has owned, directly or indirectly, a percentage holding of at least 5% in the capital or equity of the nonresident company, uninterruptedly for a year (before or after the dividend distribution).

- Moreover, this special tax may be applied to the income derived from the transfer of securities representing the equity of non Spanish resident entities which meet the holding requirement on the transfer date, provided that the transfer is made up to November 30, 2012.

  The special tax will not apply, however, to the transfer of securities representing the equity of non Spanish resident entities that own, directly or indirectly, shares in Spanish resident entities or assets located in Spain and the sum of the market value of both items exceeds 15% of the market value of their total assets.

- The special tax cannot be taken alongside the international double taxation credits under articles 31 and/or 32 of the Revised Corporate Income Tax Law.

- The special tax rate will be 10% and the tax base, in each case, will be:

  - The gross amount of the dividends or shares in income that become payable, without the ability to deduct for tax purposes any impairment losses relating to the holding that may derive from the distribution of the income subject to the special tax.

  - The income obtained on the transfer of the holding. However, the portion of the tax base relating to any value adjustment made to the transferred holding, which may have been deemed tax deductible during the holding period, will be taxed at the rate applicable to the taxpayer.

- The rules on the timing of the tax liability are as follows:

  - Liability for the tax will arise on the date on which the shareholders' meeting or equivalent body approves the resolution to distribute income.

  - In the case of the transfer of securities representing the equity of entities not resident in Spain, liability for the tax will arise on the date of that transfer.

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The special tax must be self-assessed and paid over in the 25 calendar days following the taxable event. The tax return for this new special tax will be Form 250, approved by Order HAP/1181/2012, of May 31, 2012 (which will be adapted as required).

3. PERSONAL INCOME TAX

The amendments to personal income tax are grouped around two items: the tax credit for acquisition of the taxpayer's principal residence and withholdings.

3.1 Tax credit for acquisition of the taxpayer's principal residence

Effective from the day after publication of this Royal Decree-law (in other words, already applicable for this fiscal year 2012), the compensation for acquisition of the taxpayer's principal residence applicable to taxpayers that acquired their residence before January 20, 2006 has disappeared.

Moreover, although the preamble announces the complete disappearance of the tax credit for 2013 "in a context of gradual recovery of the fundamental variables of this type of expense," that measure was not ultimately included in the articles of the Royal Decree-law.

3.2 Withholdings

Effective starting on September 1, 2012, the withholding and prepayment rate applicable to income from professional activities and to salary income derived from giving courses, conferences, symposiums, seminars and the like, or derived from the preparation of literary, artistic or scientific works, where the operation rights are licensed out, has been raised from 15% to 19%. The withholding rate for income settled or paid from September 1, 2012 to December 31, 2013, however, will provisionally be 21%.

In addition, the withholding rate applicable to income from professional activities obtained by taxpayers commencing their activity has been increased from 7% to 9%.

These percentages will be cut in half for income obtained by residents of Ceuta and Melilla who are entitled to the tax credit provided for in article 68.4 of Law 35/2006.

4. SPECIAL TAXES

Various changes have been made to the taxation of tobacco products, with the intention to increase tax revenues and as an instrument serving the aims of health policy.

Coming into effect on July 15, 2012, a minimum rate has been introduced for cigars and mini cigars (heading 1), set at a single rate of €32 per 1,000 units, which will apply where the tax payable resulting from applying the 15.8% rate is less than the amount of that single rate. The minimum rate on rolling tobacco has been raised from €75 to €80 per kilogram.

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Moreover, from September 1, 2012, for cigarettes (heading 2), the following changes have been made:

- The single rate of €116.9 has been increased to €119.1 per 1,000 cigarettes.
- The proportional tax rate of 55% has been reduced to 53.1%.
- The specific tax rate has been increased from 19% to 19.1% per 1,000 cigarettes.

5. OTHER CHANGES

5.1 Events of Exceptional Public Interest

The Madrid 2020 Olympic Bid is declared an event of exceptional public interest for the purpose of Law 49/2002, of December 23, 2002, on the tax regime for nonprofit entities and for tax incentives for patronage, for fiscal years 2012 and 2013.

5.2 Autonomous community taxes levied on electricity supply activities or facilities

According to the wording hitherto in force of article 17.4 of Electricity Industry Law 54/1997, of November 27, 1997, if the electricity activities were subject to autonomous community or local taxes, for which the tax liability was determined using non-uniform rules for the country as a whole, a regional supplement could be added to the access fee, which could differ in each autonomous community or local entity.

The new royal decree-law makes it obligatory for those autonomous communities that directly or indirectly levy their own taxes or surcharges on central government taxes on electricity supply activities or facilities to impose the territorial supplement on the access fees and last resort tariffs, which will have to be paid by consumers located in the autonomous community concerned.

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