COMMENTARY • TAX 4-2016 DECEMBER 5, 2016

ROYAL DECREE-LAW 3/2016. TAX MEASURES AIMED AT THE CONSOLIDATION OF PUBLIC FINANCES

On December 3, 2016 the Official State Gazette (BOE) published Royal Decree-Law 3/2016, of December 2, 2016 adopting measures in the tax field aimed at the consolidation of public finances and other urgent social security measures ("the Royal Decree-Law").

According to its preamble, the objective of the Royal Decree-Law is to introduce into Spanish law a number of measures directed at reducing the government deficit and correcting imbalances in the Spanish economy, by furthering and completing those introduced by Royal Decree-Law 2/2016, of September 30, 2016, which, among other steps, amended the legal regime on corporate income tax prepayments.

Notable changes in the tax field are the amendments to the corporate income tax legislation, the hike in some excise and special taxes and a tightening of the requirements laid down to apply for the deferred payment of given tax debts. These tax measures are summarized below.

1. Corporate income Tax

The new legislation on this tax, some components of which have now taken effect for this fiscal year 2016, is designed to increase revenues; in one mechanism, by eliminating the deduction of losses on investments in other companies and bringing forward the reversal of provisions recorded at an earlier date; and, in another, by placing limits on, and deferring, the use of net operating losses and double taxation credits.

1.1 Amendments effective in periods commenced after January 1, 2016

1.1.1 Limits on the use of tax loss carryforwards (and on the deduction of deferred tax assets)

Law 27/2014, the currently in force Corporate Income Tax Law (“LIS”), limits the offset of net operating losses (“NOLs”) to 70% of the tax bases before the use of the capitalization reserve and before the losses themselves are offset, subject to a minimum amount of one million euros (for fiscal years commenced in 2016 that limit is 60%). These limits also apply to the deduction of deferred tax assets (“DTAs”).

This limit applied to all corporate income taxpayers. As occurred in the years running up to the LIS, however, following the temporary measures introduced to reduce the government deficit, this Royal Decree-Law has now returned, permanently this time, to an offset regime which varies according to the taxpayer’s net revenues.

This has been implemented by adding a new additional provision to the LIS determining that for large enterprises with net revenues equal to or above €20 million in the first 12 months before the beginning date of the taxable period, concerning both the use of DTA credits and the offset of NOLs, the following limits are laid down:

- Up to 50%, where in the 12 months before the beginning date of the taxable period, the enterprise’s net revenues are equal to or above €20 million but below €60 million.

- Up to 25%, where in the same 12 month period the enterprise’s net revenues are equal to or above €60 million.

For the other enterprises, no amendments have been made, so the 70% limit remains in force for them (60% fiscal years commenced in 2016) as mentioned above.

The same limits have been introduced for cooperatives having net revenues equal to or above €20 million in the 12 months before the beginning date of the taxable period (under a new additional provision in Law 20/1990, of December 19, 1990 on the tax regime for cooperatives).

These limits do not apply to the amount of any income relating to debt recomposition or rescheduling arrangements under an agreement with the taxpayer’s creditors (which in the case of cooperatives, would have to be unrelated creditors).

1.1.2 Limit on the use of domestic and international double taxation credits.

Also for enterprises having net revenues equal to or above €20 million in the 12 months before the beginning date of the taxable period, a limit has been placed on their use of domestic and international double taxation credits, whereby the aggregate amount of both types of credits that they use cannot exceed 50% of the gross tax payable for the year.

Note that this limit applies not only to the new double taxation credits generated in or after 2016 (in respect of international or domestic double taxation under transitional provision 23 LIS) but also to any reported earlier which remain to be used. This limit, together with that mentioned in the preceding point, is going to prevent taxpayers obtaining a positive taxable base in the fiscal year before using tax credits, and recognizing sufficient tax credits in the current year or earlier years, from being allowed to have zero tax payable as a result of using their tax credits.

1.1.3 Reversal of impairment losses on investments and on the losses incurred by permanent establishments before 2013

(a) Inclusion of the reversal of impairment losses which had been deductible.

An amendment to the law eliminated, effective for periods commenced on or after January 1, 2013, the deduction for tax purposes of impairment losses on investments in the capital or shareholders' equity of enterprises; and a set of rules were provided for the recovery or inclusion in the tax base of any losses which had been tax-deductible in earlier periods, as and when the investee increased its shareholders' equity or distributed dividends. Those rules were later included in the LIS in a transitional provision.

The Royal Decree-Law has added to the rules on the recovery of those impairment losses a "minimum reversal" obligation, whereby:

- Any impairment losses which had been treated as tax deductible before fiscal year 2013 and have not yet been reversed must be recognized, at least, in equal parts in the tax base for each of the first five taxable years beginning on or after January 1, 2016.

- If under the preexisting rules on the recovery of impairment losses in the LIS a higher impairment loss had to be recovered in any of those five periods, that will be the recoverable amount in the fiscal year concerned; and the balance of the impairment loss on the shares remaining to be recovered (after that higher reversal has been included) will be included in equal parts in the remaining taxable periods.

Lastly, it is further specified that if the shares are transferred in these five taxable periods, the sums remaining to be reversed must be included in the tax base for the taxable period in which that transfer occurs, to the extent of the gain obtained on the transfer.

(b) Limit on the inclusion of losses on the transfer of permanent establishments abroad

Also for periods commenced on or after January 1, 2013, the losses sustained by permanent establishments abroad can no longer be included in the corporate income tax base. The LIS provided specifically that if the transfer of a permanent establishment took place and the regime provided in article 77.1.b) LIS (restructuring regime) was applicable, the tax base of the transferring enterprise had to be increased by the amount by which the losses exceeded the income recognized by the permanent establishment in the tax periods commenced before January 1, 2013, to the extent of the gain on the transfer of the establishment.

That treatment applied, as mentioned above, to the transfers of permanent establishments made under article 77.1.b) LIS (restructuring regime). That reference to the special restructuring regime has now been removed, so the rule now applies to all transfers of permanent establishments abroad.

1.2 Amendments effective in periods commenced on or after January 1, 2017

1.2.1 Limit on the deduction of impairment losses and losses on transfers of investments in enterprises and permanent establishments

(a) Impairment losses and losses on the transfer of "qualified" investments in enterprises or permanent establishments

The Royal Decree-Law has laid down the following:

(i) It has made non-deductible both the impairment losses and the losses on transfers of investments satisfying the requirements to claim the exemption for the avoidance of double taxation on dividends and capital gains under article 21 LIS ("qualified").

The inability to deduct losses in connection with a transfer will be partial where the right to apply the exemption is also partial.

(ii) In the same vein, it will not be allowed either to deduct the losses obtained abroad as a result of the transfer of a permanent establishment.

It expressly acknowledges, however, the right to deduct the losses arising on the extinguishment of an investee, unless it is extinguished as result of a restructuring transaction (note that no reference is made to whether the tax neutrality regime has been elected for that transaction).

In those cases, the deductible losses will be reduced by the amount of any dividends or shares in income received from the investee in the ten years before the date of its extinguishment, provided those dividends or shares in income have not reduced the cost price and have qualified for an exemption or tax credit regime for the avoidance of double taxation, in the same amount.

In the same vein, the losses incurred where a permanent establishment ceases operations may be deducted. In these cases, the deductible losses must be reduced by the amount of any net income obtained earlier and which qualified for an exemption or tax credit regime for the avoidance of double taxation, in the same amount.

(b) Reduction or non-deduction of losses on “non-qualified” investments

The Royal Decree-Law has added the following new provisions in relation to the losses obtained as a result of the impairment and the transfer of “non-qualified” investments:

- **The impairment losses on securities representing any “non-qualified” investment continue to be non-deductible.**

- Any **losses resulting from the transfer of “non-qualified” investments** (except for those in nonresident enterprises not satisfying the minimum taxation requirements under article 21.1.b) LIS) must be included in the tax base but must be reduced by the amount of any income obtained on an earlier intra-group transfer to which an exemption or credit regime for the avoidance of double taxation had been claimed.

  Additionally, the losses must be reduce by the amount of any dividends or shares in income received from the investee after the tax period in which the year 2009 commenced, provided those dividends or shares in income have not been reduced the cost price and have been eligible for an exemption for the avoidance of double taxation.

- However, **impairment losses or losses on the transfer of investments will not be deductible if they relate to:**

  - **Nonresident enterprises located in tax havens,** unless they are resident in an EU member state and the taxpayer evidences that there are valid economic reasons for their formation and operations and that they carry on economic activities.

  - **Territories falling below a minimum level of taxation** (the decree applies article 21.1.b), laying down a 10% minimum nominal rate).

- Lastly, it has removed the special rule related to losses obtained on **successive transfers of homogenous securities** (to which the standard rules will apply).

(c) Regime for the deferral of losses resulting from intra-group transfers of “non-qualified” investments

The LIS contains a special timing of recognition rule for the losses obtained on intra-group transfers of investments, which defers them to when they are transferred to third persons outside the group, or to when the transferring enterprise or the transferee leave the group.

In those cases, the LIS provides that those losses must be reduced by the gains generated on their transfer to third parties unless it is proven that those gains were taxed at a rate equal to or above 10%.

An exception is made to this rule if the transferred enterprise is extinguished, unless that extinguishment results from a restructuring transaction for which the special regime has been elected.

Following the appearance of the Royal Decree-Law:

- This rule has been retained only for the transfer of "non-qualified" investments and, in the case of nonresidents, provided they satisfy the requirements in article 21.1.b) LIS, now that the losses resulting from the transfer of "qualified" investments or of non-residents not meeting the requirements in article 21.1.b) LIS, have been made non-deductible.

- It has also been laid down that the reduction of the losses in the amount of the gains generated on the transfer to third parties will occur in all cases by removing the reference to the 10% minimum taxation from the LIS.

- Where an investee is extinguished its losses may be included unless they result from a restructuring transaction (rather than only those for which the special deferral regime has been elected) or in any event in which it continues operating.

(d) Regime for decreases in value as a result of adjusting investments to fair value

The Royal Decree-Law makes non-deductible any value decreases in "qualified" investments resulting from applying the fair value standard which are recognized in the statement of income, unless an increase in value had first been included in the tax base in the same amount as a result of the investment in homogenous securities.

This same rule is laid down for investments in nonresident entities not satisfying the minimum taxation requirements under article 21.1.b) LIS.

1.2.2 Exemption for the avoidance of double taxation

The following amendments have been made to the exemption regime for the avoidance of double taxation concerning how it may be claimed for the gains obtained on the transfer of investments:

(a) In relation to the limit on claiming the exemption for investments valued under the tax neutrality regime

Article 21.4 LIS sets out certain limits on claiming the exemption for investments valued under the tax neutrality regime. These limits are specified where the investments being transferred were acquired as a result of (i) transfers of investments in entities failing to satisfy all or part of the various requirements for the exemption; or of (ii) non-monetary contributions of assets other than

investments; where, under the valuation rules in that neutrality regime, they had determined that income did not have to be included in the corporate income tax, personal income tax or nonresident income tax base.

Therefore, in these cases the exemption basically applies on the gain relating to the positive difference between the transfer value of the investment in the enterprise and the market value of that enterprise at the time of its acquisition by the transferring enterprise.

Moreover, in cases of successive transfers of homogenous securities, the exemption is limited to the excess over the amount of the net losses obtained on earlier transfers which had been included in the tax base.

The amendments that the Royal Decree-Law has now made to this treatment are as follows:

- It has defined more precisely, by clarifying it, the first scenario giving rise to the limit, by replacing the general reference to the "transfer" of an investment that fails to satisfy the requirements for the exemption with the "contribution" of that investment.
- It has simplified the rule determining non-eligibility for the exemption with respect to the income deferred by the transferor on the original contribution. It has also clarified that this rule will not apply if it is proven that the transferee has included the relevant amount of income in its tax base.
- A specific rule has been laid down for cases in which the contribution was made by taxable persons for personal income tax purposes. Specifically, where the contributed investment is transferred in the two years following the contribution, the exemption will not apply on the positive difference between the value for tax purposes of the securities received by the transferee entity and their market value on acquisition, unless it is evidenced that the individuals transferred their investment in the entity in the period referred to above.
- The rule limiting the exemption in cases of successive transfers of homogenous securities has been removed.

(b) Lastly, further technical amendments have been made to the corporate income tax legislation and to the regime on Spanish REITs (*Sociedades Anónimas Cotizadas de Inversión en el Mercado Inmobiliario* – SOCIMI-) in relation to the rules on the exemption.

Specifically, in Law 11/2009, on SOCIMIs, where it says that if the transferor or recipient is a corporate income or nonresident income taxpayer with a permanent establishment, the exemption in article 21 LIS will not apply, it has been added that this will be so "in relation to the gains obtained".

1.2.3 Rules for the avoidance of double taxation in transactions for which the special neutrality regime is elected

Under the special tax neutrality regime, a number of specific rules are applied aimed at avoiding the double taxation that might arise on contribution and exchange transactions by applying the valuation rules provided in that regime. The Royal Decree-Law adds two technical refinements:

(a) Firstly, for the shareholder to claim the exemption on the transfer of the investment received by reason of the exchange or the contribution, the deferred income attributable to the contributed assets must first have been included in the tax base.

(b) Moreover, the reference to “how the transaction was recognized” in connection with the correction of double taxation at the transferee entity has been removed.

2. Excise and special taxes

In the field of excise and special taxes, as highlighted in the preamble to the Royal Decree-Law, the measures center on increasing the rates for the tax on intermediate products and the tax on spirits and alcoholic beverages, and the tax on tobacco products. These measures come into force on its publication date in the Official State Gazette.

2.1 Tax on intermediate products and tax on spirits and alcoholic beverages

The tax rates on the consumption of intermediate products, spirits and alcoholic beverages have been raised by 5% in mainland Spain and in the Canary Islands.

2.2 Tax on tobacco products

For the tax on tobacco products, the weight of the specific component with respect to the *ad valorem* component has been increased while making the resulting adjustment to the minimum level of tax, for both cigarettes and for rolling tobacco.

This measure has meant one step further in the process for reforming the tax structure of these products which started with Royal Decree-Law 12/2012, and is aimed at gradually securing a better balance between the percentage element of the tax linked to the price in relation to the specific element determined by product unit, all of the above in harmony with the current taxation in other member states.

3. Tax procedure. Deferred or split payment of tax debts

Effective January 1, 2017, it will no longer be possible to defer or split the payment of certain tax debts. Specifically, article 65.2 of General Taxation Law 58/2003, of December 17, 2003 (the "LGT") has been amended to include three new cases in which given tax debts cannot be deferred or split, namely:

- Those resulting from the enforcement of final decisions that fully or partially set aside an appeal, an economic-administrative claim or an application for judicial review in which the tax debt in question was previously stayed while the appeal or claim proceeding was in progress.

- Those arising from taxes that may legally be charged, unless it is duly evidenced that the charged amounts have not effectively been paid.

- Those arising from the obligation to make prepayments on account of corporate income tax.

Applications to defer or split the payment of the above tax debts will not be admitted, meaning that they will be deemed not to have been submitted for all intents and purposes and that, therefore, once the voluntary payment period elapses, the enforcement period will automatically commence.

The new legislation also eliminates the exception that permitted, under certain exceptional circumstances, the tax obligations of withholding agents (for payments in cash or in kind) to be split or deferred. Accordingly, starting January 1, 2017, these tax debts will not be deferrable under any circumstances.

Until now these debts were only deferrable in the exceptional cases in which it was deemed evidenced that the taxpayer had insufficient assets to secure the debt and that enforcing payment against the taxpayer's assets could materially affect the continuation of production capacity and the level of employment in the respective economic activity, or could lead to serious detriment to the interests of the public treasury.

In any event, any deferred or split payments commenced before January 1, 2017 will be governed by the legislation in force before that date and, therefore, will not be affected by these new developments.

In addition, the option of paying in kind with respect to all non-deferrable tax debts has been eliminated (that is, both with respect to the cases already included in the legislation, and with respect to the new cases included by the Royal Decree-Law itself). Applications to pay in kind with respect to these cases will not be admitted.

4. Wealth Tax

The requirement to levy wealth tax has been extended to 2017 with a view to helping to maintain the consolidation of the public finances, mainly those of the autonomous communities. In any case, it must be recalled that some autonomous communities have been offering tax reductions which bring the wealth tax charge to zero in practice.

If no subsequent changes are introduced, the 100% wealth tax reduction will be recovered in 2018 and it will no longer be mandatory to file the wealth tax return.

5. Revision of cadastral values

Every year, the indexation allowance multipliers for cadastral values are approved in the General State Budget Law (the "LPGE"). However, since it was not possible to process the LPGE for 2017 on time, the Royal Decree-Law has been used as a channel for their approval to the extent that the revision of the cadastral values has an immediate impact on the real estate tax, a tax which falls due on January 1 of each calendar year.

Specifically, the indexation allowance multipliers for cadastral values have been set for 2017 according to the following table:

Year of entry into force of comparative values	Indexation multiplier
1984, 1985, 1986, 1987, 1988, 1989 y 1990	1,08
1994	1,07
1995	1,06
1996	1,05
1997, 1998, 1999 y 2000	1,04
2001, 2002 y 2003	1,03
2005, 2006, 2007, 2008 y 2009	0,92
2010	0,90
2011	0,87

These multipliers will apply to the municipalities included in Order HAP/1553/2016, of September 29, 2016, as follows:

(a) In the case of real estate valued according to data on file at the Real Estate Cadaster, the multipliers will apply to the value assigned to those assets for 2016.

(b) In the case of cadastral values notified in fiscal year 2016, obtained from applying the partial comparative values approved in that year, they will apply to those values.

(c) Where alterations have been made to the characteristics of the real estate, according to the data on file at the Real Estate Cadaster, and the changes have not become effective, the multipliers will apply to the value assigned to those properties according to the new circumstances, by the Directorate-General of the Cadaster, using the modules that would have served as a basis for setting the cadastral values of the other properties in the municipality.

6. Entry into force

The Royal Decree-Law came into force on date it was published in the Official State Gazette, that is, on December 3, 2016, although not all of its provisions take effect on that date. The effective dates of each of the measures described in this Commentary have been indicated in the relevant sections above.

In any case, the Royal Decree-Law must be approved by the lower house of the Spanish parliament.

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