Tax Newsletter

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Contents

2.9 Tax on increase in urban land value.- The constitutional court judgment that overturned the tax may be pleaded ex novo in a proceeding to challenge an assessment

2.10 Administrative procedure. - The principle adopted by an autonomous community government is not an own act that is binding on the central government

2.11 Management procedure. – Increase to scope of work in a limited review is valid only if notified before the period for comments is initiated

2.12 Management procedure. - The tax authorities must ensure that a request is handled, even if it was filed with a competent body

2.13 Audit procedure. – Nullity of a warrant to enter and search a home requires return of all seized documents and destruction of all copies held by the authorities

2.14 Audit and management procedure. - The tax authorities cannot make a third assessment in respect of the same tax and tax period, after voiding the two previous ones if there are no new facts or circumstances supporting this

2.15 Review procedure. – Where a decision dismissing action to set aside a decision is challenged, the court may also examine the factual issues submitted in the original claim

3 Decisions

3.1 Corporate income tax. - Horizontal tax group regime introduced by the current corporate income tax law is not applicable to fiscal years before it came into force

3.2 Corporate income tax.- Inventory write-down provision not based on substantiated decline in market value is not deductible

3.3 Corporate income tax. - Accounts payable and receivable in cash pooling systems should earn equivalent amounts of interest

3.4 Corporate income tax. – International double taxation tax credit can be applied on foreign income even if the foreign tax was paid in a later year

3.5 Personal income tax. - The recipient of income may deduct withholdings not made only if they report the income voluntarily and the tax authorities' right to claim from the payer is not statute-barred

3.6 Personal income tax. - Real estate income cannot be recognized in respect of real estate owned as community property and used in an economic activity carried on by one of the spouses

3.7 Personal income tax. - The three-year holding period for considering for personal income tax purposes that an asset is used in an economic activity only applies to assets coming out of personal property

3.8 Personal income tax.- Exemption for capital gain on reinvestment in principal residence in the same year as the transfer is not an electable option subject to a time limit

3.9 Transfer and stamp tax. - Exemption for transfer of shares in entities engaged in construction or real estate development may only be applied where they are the only activities in their corporate purposes

3.10 Transfer and stamp tax. - Deed for cancellation of a condition precedent is an act subject to stamp tax

3.11 Administrative procedure. - A change of principle by the Supreme Court to the detriment of the taxpayer can only be applied from when it occurs

3.12 Management procedure.- The time limit for enforcing economic-administrative decisions partially upholding claims and arising from management procedures is one month and failure to meet the time limit only determines that late-payment interest is not chared

3.13 Collection procedure. - Notification of attachment to holders of rights in rem in the attached asset does not entitle them to challenge it

3.14 Collection procedure. – Against an audit of reported values performed by the tax authorities in a procedure for declaring joint and several liability, the interested party may request an expert appraisal made at the taxpayer's instance

4 Resolutions

4.1 Corporate income tax.- Each company in a coordination group has to fulfill the requirements individually to consider that an economic activity exists

4.2 Corporate income tax.- Dormant companies may belong to a tax group

4.3 Corporate income tax.- Analysis of the treatment applicable to indemnification for damage to a building caused by explosion at a neighboring factory building and the works to repair it

4.4 Corporate income tax.- Expense caused by a scam is deductible if the facts can be evidenced

4.5 Personal income tax.- Analysis of the tax on overall per diems that are not divided into living and accommodation expenses

4.6 Nonresident income tax.- Property leasing is not an industrial activity for the purpose of avoiding the taxation of capital gains

4.7 Transfer and stamp tax. – Transfer and stamp tax must be self-assessed using the reference value, even if it is lower than the sale price, although it may be contested later

4.8 Administrative procedure. – The legal personality of an entity cannot automatically be ignored to allocate ownership of its assets, for tax purposes, to its owner or director

5 Legislation

5.1 New form 490 approved for self-assessment of the tax on certain digital services

5.2 Reduction of the net income indexes applicable under the personal income tax objective assessment method for agricultural and livestock farming activities.

5.3 Corporate income tax return forms for fiscal year 2021 have been published

1. Personal income tax filing season: a few principles to be considered on determining transfer value in sales of unlisted shares

Several courts have pronounced on the special pricing rule for transfers of unlisted shares and in particular on how to apply the rule to transfers of shares in dormant or newly created companies. They have also pronounced on the burden of proof in relation to market value and on whether a limited review is a valid procedure for examining these transactions.

With the personal income tax filing season in full swing, and in view of recent decisions and judgments, this is a good time to recall the personal income tax treatment of transfers for a consideration of unlisted shares.

Under article 34 of the Personal Income Tax Law, in transfers for a consideration the capital gain or loss is determined by reference to the difference between the assets' acquisition costs and transfer prices. As a general rule, the transfer price is the actual value at which the transaction was performed, less any expenses and taxes incurred on it. In relation to transfers for a consideration, however, article 37 provides a special valuation rule for shares.

Under that rule, the transfer value cannot go below the higher of the following two amounts (unless it can be substantiated that the paid sum is equal to the amount that would have been agreed between independent parties on an arm's length basis):

(i) The net equity figure disclosed on the balance sheet for the latest fiscal year-end before the due date for the tax.

(ii) The figure obtained by capitalizing at 20% (multiplying by 5 in other words) the average earnings figure for the latest three fiscal to end before the due date for the tax, and computing any paid dividends and allocations to reserves as income (excluding amounts recorded in respect of asset revaluation).

A host of doubts have arisen over application of these special rules, and a few have been resolved in recent decisions and judgment:

(i) Newly created companies and dormant companies

In a decision delivered on April 26, 2022 (**Principle 1** **and** **Principle 2)**, TEAC examined how to calculate the capitalization of earnings where the entity was created in either of the two years that ended before the due date for the tax, in other words, where on the due date, the earnings figures for the company's three fiscal years preceding the due date referred to in the law are not available. The tribunal concluded that in these cases the capitalization rule does not apply. In other words, the minimum transfer value will be the net equity figure for the latest year to end before the due date for the tax.

The tribunal clarified however that the rule is applicable by contrast where the owned company had been dormant, and not obtained either a loss or income in any of the three fiscal year-ends preceding the due date. In these cases the earnings figures for those years must be considered to be "0" and the average figure must be calculated for those three years.

(ii) Proof of adequacy of the price paid and of the market value

The Galician High Court recalled, in a judgment delivered on April 4, 2022, that for the purposes of undermining the presumed price under the law, the burden of proving that the paid price matches market value lies with the interested party rather than with the tax authorities.

The taxpayer may therefore question the value that the authorities calculated using the company's balance sheets, for example, by showing that the company's accounting records do not reflect its actual economic circumstances. If this is so and can be substantiated by the taxpayer, it should be possible to correct the value calculated by the tax authorities.

Furthermore, if the taxpayer produces an expert report proving these points, its validity cannot be rejected by the tax authorities without justification. In this specific case, the court accepted the credibility of the produced report (evidencing that the company's actual value is close to "0"), even though the calculations made by the expert were based on data produced by the taxpayer.

Lastly, several judgments have been published by the high courts for Castilla-La Mancha (March 29 , April 6, March 29 and April 25, 2022) and Castilla y León (April 13, 2022) in which the use of a limited review procedure to modify the gain reported by the taxpayer on the transfer of unlisted shares is questioned.

As noted by these courts, a modification of the transfer value by applying that special rule necessarily requires an analysis of the investee's accounting records, which is prohibited in this type of procedure. This conclusion is not altered by the fact of the taxpayer not questioning the accounting data in the course of the procedure. In other words, "*it is not correct to set the scope of the prohibition on examining the company's accounts and, as a result, make the validity of a tax management procedure conditional on the very specific defense or excuse strategy employed in each case by the interested party since clearly that approach … does not appear to respect the principle of legal certainty, without prejudice to whether the taxpayer reporting a transfer value as a market value that differed from the carrying or listed amount, entailed or implied a denial or questioning of the accounting data …"* (Castilla y León high court judgment of April 13).

2. Judgments

2.1 Relationship absorption theory.- EU law precludes a person simultaneously performing CEO and director duties at a company not being able to be classed an employee

Court of Justice of the European Union. Judgment of May 5, 2022. Case C-101/21

In relation to an employment issue, this judgment examined the Czech law transposing Directive 2008/94/EC of 22 October, 2008 on the protection of employees in the event of the insolvency of their employer.

Under that national law an individual simultaneously performing the duties of board member and CEO at a company cannot be classed as an employee (which is similar to the Spanish "*teoría del vínculo*" or relationship absorption theory crafted by the courts and used widely by the tax authorities and courts, among other cases, to deny the deduction of directors' compensation where corporate law is not closely complied with). Accordingly, these workers are not covered by the protection mechanisms in that law and therefore in the directive.

According to the European Court (CJEU), this law is precluded by the directive. Although the directive authorizes member states to exclude the claims of certain categories of employees from its scope, this is only possible if they provide an equivalent degree of protection, which is not the case with Czech law.

In short, the fact that a person performing the duties of CEO of a company is also a member of the statutory body of that company does not, in itself, allow for the presumption or exclusion of the existence of an employment relationship or the classification of that person as an employee.

2.2 Form 750 - Ownership of cash reported on form 750 needs no further substantiation than the statement made by filing that return

National Appellate Court. Judgment of March 17, 2022

Form 750 allowed taxpayers to make adjustments to their positions in relation to various taxes, by paying over 10% of the acquisition cost or value of the adjusted assets or rights. These assets or rights had to be owned by the taxpayer as of December 31, 2010.

In the case examined in this judgment, a taxpayer had filed form 750, reporting a sum in a bank account owned by the taxpayer. In 2010, the taxpayer had a community property arrangement for marital property, but when the form was filed in 2012 a separate property arrangement was in place.

In personal income tax audit work later initiated on her spouse, the auditors concluded that the cash was community property not separate property. They therefore adjusted his position by including in his taxable income half of the balance of the deposit as an unreported capital gain.

The National Appellate Court accepted the taxpayer's arguments and concluded that the legislation on the special tax return provided that in the case of cash, the filing of form 750 was sufficient proof in itself. Because his spouse reported on that form the gross balance of the deposit and paid over the resulting debt out of a separately owned account (when the separate property arrangement was in force), it had to be considered that the account was not community property.

2.3 Form 720 – Three-month period for initiation of penalty proceeding does not apply in cases relating to late filing of Form 720

Supreme Court. Judgments of April 29, May 11, May 12 and May 17, 2022

Article 209.2 of the General Taxation Law (LGT) states that penalty proceedings cannot be initiated after three months (now six months) have run from when the relevant assessment or decision was notified.

The Supreme Court concluded in these judgments that this article (and therefore that period) only applies where the penalty proceeding is the result of a verification of reported values, examination or audit process. As a result, it does not apply in penalty proceedings initiated as a result of the late filing of Form 720.

Moreover, in all these judgments the Supreme Court ordered a reversion of procedure for the lower court to deal with and decide on the appeals against the penalties in respect of the late filing of Form 720, so that it could take into account the CJEU judgment of January 27, 2022, delivered in case C-788/19 and, discussed in our alert dated January 27, 2022.

2.4 Corporate income tax. – For an expense relating to forgiven debt to be deductible, evidence of collection attempt is needed

National Appellate Court. Judgment of March 28, 2022

Tax auditors considered that the expense recognized by an entity as a result of partial forgiveness of a claim against another unrelated entity was a free gift and therefore not deductible. According to the auditors, no evidence had been provided in the procedure that the appellant had made any type of attempt to achieve payment of the claim (through renegotiation, deferral, legal proceedings, etc.).

The company argued against this that the aim of partial forgiveness of the claim was to ensure payment of the amount that had not been forgiven, in view of the client's troubled financial situation which in actual fact resulted in it being wound up.

The National Appellate Court recalled that the simple fact of the debtor company having financial troubles does not prevent the company holding the claim from attempting to collect the debt. It had not been evidenced in the proceeding that any attempt was made to collect all or part of the debt or that any negotiations had been conducted either, and therefore it was a nondeductible free gift.

2.5 Corporate income tax. - An insolvency order on the related party debtor is sufficient to deduct impairment of the claim

Galician High Court. Judgment of February 7, 2022

Under article 12 of the revised Corporate Income Tax Law (TRLIS), provisions for impairment losses on claims recorded by reason of the potential inability of its customers to pay are deductible in the event of a declaration of insolvency by a court. The appellant company applied this rule to deduct from its tax base impairment losses on a claim held with a related company that had been the subject of an insolvency order. The auditors considered that the insolvency order was sufficient in the case of ordinary claims although not in relation to claims with related companies. In this second case, in the auditors' opinion, "insolvency declared by a court" within the meaning of the corporate income tax legislation may only be considered to be that arising from initiation of the liquidation phase.

The Galician High Court recalled that, under the insolvency legislation, for a court to issue an insolvency order on a company evidence must be provided of the debtor's insolvency or indebtedness, which the judge has to consider in order to decide whether an insolvency order is to be issued. Therefore, in the insolvency order the existence of the debtor's insolvency has already been assumed (even if it is a company related to the creditor). The court therefore accepted the taxpayer's arguments and allowed the provision to be deductible.

2.6 Personal income tax. – Providing use of a vehicle to shareholders is taxed as income on movable capital

Supreme Court. Judgment of April 27, 2022

At issue in this judgment were (i) the characterization for tax law purposes of income obtained as a result of a company providing use of or making available a vehicle to its shareholder, and (ii) the pricing of this type of income.

The Supreme Court concluded that:

(a) Providing use of or making available vehicles owned by the company to its shareholders must be taxed as income on movable capital on the personal income tax returns of the recipients.

(b) If it is a controlled transaction, it must be valued at arm's length under the provisions in article 41 of the Personal Income Tax Law, as had been concluded by the court itself in a recent judgment dated February 9, 2022 (March 2022 Tax Newsletter).

The pricing rules in article 43 of the Personal Income Tax Law are therefore not applicable, because these rules relate to salary income in kind (and in some cases, to capital gains in kind) but not to income in kind from movable capital.

2.7 Nonresident income tax.- EU law precludes withholdings on dividends received by a company from subsidiaries resident in another member state, when they are distributed to shareholders, where the tax is higher than 5% of income

Court of Justice of the European Union Judgment of May 12, 2022. Case C-556/20

The CJEU has held to be precluded by the parent-subsidiary directive a national law (French law in this case) according to which a parent company redistributing among its shareholders the dividends it received from its subsidiaries has to make an advance payment of tax (and accordingly recognize a tax asset) where those dividends have not been taxed in respect of corporate income tax at the standard rate; but only where the withheld amounts exceed 5% of the income distributed by the subsidiary.

According to the court, the directive excludes from its reach national laws designed to lessen double taxation on dividends and in particular provisions relating to the payment of tax assets to the beneficiaries of those dividends. The court clarified however that this exception must be interpreted strictly and concluded that a national law such as that described does not fall under the provisions mentioned and therefore has to respect the directive's requirements.

2.8 VAT. – Analysis of VAT treatment of services provided by players' agents and of temporary transfers of players

National Appellate Court. Judgment of March 23, 2022

The National Appellate Court has pronounced on the VAT treatment of the following transactions and payments:

(a) Payments made by clubs to agents of their players: according to the court, the customers of the services supplied by agents or representatives of football players are the players themselves, not the club, which may be determined from the contracts, the football industry rules and regulations and the fact that their actions inure to the benefit of the players. For that reason, although the price is paid by the club, it cannot deduct the input VAT.

However, this issue is awaiting a decision by the Supreme Court (admission decision dated March 30, 2022 in cassation appeal 5730/2021).

(b) A temporary transfer for no consideration: according to the National Appellate Court, this transaction is a supply of services for consideration and the consideration is the player's greater value following the training and experience received at the transferee club. The taxable amount for this transaction is the amortization (over the transfer period) of the price paid to acquire the player, plus any amounts that the transferee club has to pay the player.

2.9 Tax on increase in urban land value.- The constitutional court judgment that overturned the tax may be pleaded ex novo in a proceeding to challenge an assessment

Madrid High Court Judgment of March 2, 2022

An entity challenged an assessment of the tax on increase in urban land value issued by a local authority as a result of the transfer of a commercial property.

While its judicial review appeal was still in progress, the Constitutional Court issued judgment 182/2021 of October 26, 2021 in which it held to be unconstitutional and null and void a few articles of the revised Local Finances Law, relating to the system for determining the taxable amount for the tax. We summarized this judgment in an alert dated November 3, 2021.

The entity produced the judgment in the proceeding for it to be taken into account to render a decision on its appeal. The local authority submitted to the court that the judgment should not be taken into account because, until that point, the entity had focused its challenge on issues relating to consideration of the evidence on the actual increase in value that occurred with the sale of the property and not on the nullity of the rule.

The Madrid High Court accepted the taxpayer's arguments, however, and overturned the assessment. According to the court, the assessment, challenged within the time limit (and therefore not final), was affected by an invalidating defect, because it was issued on the basis of articles held unconstitutional. The nullity of the assessment is not affected by the fact that neither of the parties in the proceeding had pleaded nullity until the constitutional court judgment appeared.

This same view was given by the Madrid High Court in judgments dated February 22, 2022, on appeals 558/2021 and 619/2021.

2.10 Administrative procedure. - The principle adopted by an autonomous community government is not an own act that is binding on the central government

National Appellate Court. **Judgment of March 28, 2022**

The central government tax authorities failed to confirm the validity of a reduction applied by an entity on its corporate income tax self-assessment, in relation to certain amounts recorded in the reserve for investments in the Canary Islands (RIC). According to the tax authorities, the company had not substantiated the requirement for the investment to have been materialized (i.e. the properties in respect of which the reserve was recorded must have been brought into operation) within three years from the due date for the tax in the period when the amount was recorded in the reserve. It underlined that those properties were not leased (and therefore were not brought into operation) for at least five years after they were purchased.

The appellant entity submitted that, in an audit on another tax incentive (exemption from transfer and stamp tax for entities with permanent establishments in the Canary Islands), the Canary Islands tax authorities had audited that same requirement relating to the bringing into operation of the properties and had concluded favorably.

The National Appellate Court rejected the claim that the autonomous community authorities' conclusion binds AEAT. According to the court, they both have their own separate personality. Moreover, the examination made by the Canary Islands authorities related to a different tax incentive from that examined by AEAT, and therefore, even though the facts are identical, they may be assessed and considered differently.

This ruling was added to other earlier rulings by the same court, in which a restriction is placed on applying the principle of prohibition of going against their own acts.

2.11 Management procedure. – Increase to scope of work in a limited review is valid only if notified before the period for comments is initiated

Supreme Court. **Judgment of May 3, 2022**

Article 161.1 of the Regulations on the application of taxes provides that *"before initiation of the period for comments, the tax authorities may decide on a reasoned basis to increase or reduce the scope of the work*".

Based on the wording of that law, the Supreme Court concluded that an increase to the scope of a procedure is not valid if that increase is not notified before the period for comments. It is not possible, therefore, to notify the increase at or after the start of that period.

The court added that adequate reasons must be provided for the increase.

2.12 Management procedure. - The tax authorities must ensure that a request is handled, even if it was filed with a competent body

National Appellate Court. **Judgment of March 17, 2022**

A taxpayer transferred in 2010 a number of shares in an entity and included the associated capital gain in taxable income for personal income tax purposes in that tax period. That gain was calculated using the agreed price for the sale which appeared in the deed. The

purchasing entity breached the agreed payment terms and conditions, which led to the commencement of a civil proceeding that ended with a judgment, notified in March 2018, terminating the contract and ordering payment of indemnification to the appellant.

In view of the judgment, the taxpayer filed in May 2018 a submission to AEAT, requesting a "voiding of the reported capital gain" in 2010. No reply was obtained to this request for a refund of tax incorrectly paid. Later, in June 2018, the appellant filed this same request with TEAC, which handled it as an extraordinary appeal for review. However, because the submission had been filed more than three months after the date of notification of the civil judgment, TEAC did not admit the appeal due to being filed outside the time limit.

The National Appellate Court accepted the appellant's arguments and concluded that the date the first submission was filed with AEAT in May 2018 should have been considered the lodging date of the extraordinary appeal for review. In the court's opinion, the fact that the request filed with AEAT had based the "voiding" of the capital gain on the judgment declaring termination of the contract provided clear and unambiguous evidence that it was an extraordinary appeal for review, not a request for a refund of tax incorrectly paid. Therefore, AEAT should have taken all the steps needed to ensure that it was handled as an appeal for review.

The court underlined, moreover, that a consequence of AEAT's inaction cannot be a decision not to admit the appeal, to the detriment of the taxpayer's interests. Accordingly, it ordered for the submission to be handled as an extraordinary appeal for review to TEAC.

2.13 Audit procedure. – Nullity of a warrant to enter and search a home requires return of all seized documents and destruction of all copies held by the authorities

Supreme Court. **Judgment of May 12, 2022**

After a search warrant for a home issued by a court was rendered null and void on the basis of insufficient substantiation, the taxpayer filed an appeal for judicial review in a proceeding to protect fundamental rights to secure a decision holding (i) that the entry and search was a breach of its fundamental rights and (ii) that the seized items of proof, information, computer records and other documents could not be used by AEAT.

The Supreme Court, in line with its findings in judgment 1174/2021 (discussed in our October 2021 Tax Newsletter), concluded that the decision rendering null and void the search warrant issued by a court for a private home removes any legal cover for the tax authorities' actions and requires them to return all seized documents, and to destroy any copies of those documents held by the tax authorities.

However, the court separated the obligation to destroy the documents from the inability to reverse the fact that they had already been examined. For that reason, the court added that it cannot rule on the possibility that any knowledge obtained may be used, and that this issue will have to be decided, should the case arise, in any administrative or judicial proceeding in which the authorities or another party attempts to use that knowledge.

2.14 Audit and management procedure. - The tax authorities cannot make a third assessment in respect of the same tax and tax period, after voiding the two previous ones if there are no new facts or circumstances supporting this

National Appellate Court. Judgment of March 16, 2022

As a result of examination work, the tax authorities issued a first assessment in respect of corporate income tax, which was later voided by the regional economic-administrative tribunal (TEAR), although it ordered reversion of procedure to correct any identified defects. As part of the enforcement of the TEAR's decision, a second assessment was issued which was also challenged. After a motion against an enforcement decision was filed, a new reversion of procedure took place and a third assessment was issued.

In relation to an appeal brought with the National Appellate Court, the tax authorities supported the validity of a third assessment, due to the different errors in the first and second assessments.

However, by applying the supreme court's case law following its judgment of March 11, 2021 (appeal 80/2019), the National Appellate Court recalled that a third assessment may only be issued in relation to the same tax obligations where new facts or circumstances are discovered as a result of different work from that already performed.

2.15 Review procedure. – Where a decision dismissing action to set aside a decision is challenged, the court may also examine the factual issues submitted in the original claim

Supreme Court. Judgment of May 3, 2022

A taxpayer brought action to set aside a TEAC decision (under article 241.bis of the General Taxation Law), and pleaded complete and manifest inconsistency. Following dismissal of that action to set aside, an application for judicial review was filed. In that proceeding, the National Appellate Court refused to enter into examining the factual grounds for challenging submitted by the claimant. In the court's opinion, those grounds should have been contended in the challenge of the original decision which was the subject matter of that action to set aside, not in the proceeding against the decision on that action (decision dated January 31, 2018), which is based on defined and specific grounds.

The Supreme Court accepted the appellant's arguments and concluded that, where a decision dismissing action to set aside a TEAC decision is challenged, the competent court in the judicial review jurisdiction can and should examine the original TEAC decision that was the subject matter of the action to set aside. In other words, in this case, the National Appellate Court should have heard and decided on the factual grounds pleaded by the claimant, and in short, verified the accuracy or otherwise of the act that was originally challenged; the original TEAC decision, in other words.

3 Decisions

3.1 Corporate income tax. - Horizontal tax group regime introduced by the current corporate income tax law is not applicable to fiscal years before it came into force

Central Economic-Administrative Tribunal. Decision of April 26, 2022

The repealed Revised Corporate Income Tax Law (TRLIS) did not contain a horizontal tax group regime. In other words, the parent company could only be a Spanish resident entity or, otherwise, a permanent establishment (PE) of a nonresident entity located in Spain with respect to the shares held by that company. Under the current Corporate Income Tax Law (LIS), nonresident entities may be parent companies, in which case the group will consist of the subsidiaries of those entities which are Spanish resident and of permanent establishments of nonresident entities with respect to which the requirements to form part of the consolidated tax group are met.

In the case examined in this decision, the appellant argued that the inclusion of permanent establishments in the definition of subsidiary in the current LIS is simply a consequence of the new description of the (horizontal) tax group regime to adapt it to EU law, in which the definition of parent company includes nonresident companies.

It therefore supported that the subsidiaries in the tax group should include two branches (permanent establishments of non Spanish resident entities) by applying the horizontal tax group regime retroactively.

TEAC reached the opposite conclusion. According to the court:

(a) The fact that permanent establishments of nonresident entities were included among subsidiaries following the entry into force of the LIS does not mean that the fact that this option was not allowed earlier automatically determines an infringement of EU law.

(b) The new rules included in the LIS for these purposes did not involve the correction of any incompatibility in the previous Spanish legislation with the principles of EU law, but rather was the result of the legislature's own decision.

In short, the amendment to the legislation must be applied from when the new LIS came into force.

3.2 Corporate income tax.- Inventory write-down provision not based on substantiated decline in market value is not deductible

Central Economic-Administrative Tribunal. Decision of April 26, 2022

TEAC concluded in this decision that an inventory write-down provision is not deductible for corporate income tax purposes where it is not based on a substantiated decline, which has already occurred, in the market value of those inventories, and instead on a simple expectation of a decline. The decline in value cannot be considered substantiated for these purposes simply by reason of the passage of time.

In other words, a write-down provision or impairment loss in respect of inventories must be recorded for accounting purposes as required under the accounting rules and is considered to be a tax deductible expense only where on the period end date, it is substantiated that their market values are lower than their acquisition prices or production costs.

3.3 Corporate income tax. - Accounts payable and receivable in cash pooling systems should earn equivalent amounts of interest

Central Economic-Administrative Tribunal. Decision of March 23, 2022

A business group's cash pooling system determined different interest rates according to whether the sums were accounts payable and accounts receivable. The auditors considered that this difference was not allowable.

TEAC reached the same conclusion as the auditors. According to the tribunal, in a cash pooling system, it is not acceptable for accounts payable and accounts receivable to earn different rates, because the amounts of income in the system relate to all the participants. As was stated by the auditors, in systems of this type (i) the system manager does not carry out the functions of a financial institution and (ii) the participants are contributors or recipients of funds, and the receivable or payable balance of each is generally not known beforehand.

3.4 Corporate income tax. – International double taxation tax credit can be applied on foreign income even if the foreign tax was paid in a later year

Galician Regional Economic-Administrative Tribunal. Decision of October 29, 2021

A company included foreign income in its 2016 tax base, and applied the international double taxation tax credit in respect of the tax paid on that income, even though the tax was not paid in 2016, and instead in 2017.

The tax authorities disallowed use of the tax credit. According to AEAT, a taxpayer cannot deduct in one fiscal year a foreign tax that was paid in a later year.

The Galician TEAR, however, confirmed that the tax credit was allowable because (i) when the taxpayer filed its self-assessment for 2016 in 2017, it already knew the tax paid in another country, and moreover, (ii) this is the only logical solution from the standpoint of matching the income received (and reported) and the tax paid in another country on that income.

3.5 Personal income tax. - The recipient of income may deduct withholdings not made only if they report the income voluntarily and the tax authorities' right to claim from the payer is not statute-barred

Central Economic-Administrative Tribunal. Decisions of April 26, 2022 (0219/2019 and 4937/2019)

Under the personal income tax legislation, the recipient of income on which no withholding was made (or the withholding was below the required amount) is allowed a deduction from tax liability of the amount that should have been withheld.

TEAC examined the requirements for deducting those outstanding withholdings in the cases of taxpayers that had received severance payments on which no withholdings were made although, after a review by the authorities, they were considered taxable. It found that the requirements are as follows:

(a) The taxpayer should have reported the received amount of income on their self-assessment as taxable and non-exempt income. In other words, the withholding cannot be deducted if the income is disclosed as part of audit work.

(b) The reason for withholding a lower amount than was required must be attributable only to the withholding agent. In other words, where the reasons for the withholding deficiency may be attributed in whole or in part to the recipient of the income, only amounts actually withheld may be deducted.

(c) The tax authorities' right to seek the unpaid withholdings from the payer, through the relevant assessment must not be statute-barred, because otherwise there would be an unjust enrichment for the recipient.

3.6 Personal income tax. - Real estate income cannot be recognized in respect of real estate owned as community property and used in an economic activity carried on by one of the spouses

Castilla-La Mancha Regional Economic-Administrative Tribunal. Decision of February 11, 2022

A couple owned a real estate asset as community property, and one of the spouses conducted an economic activity in that property. The tax authorities considered that the spouse that did not conduct the activity should have reported in their self-assessment real estate income in respect of 50% of the real estate asset.

The Castilla-La Mancha TEAR concluded, however, that no real estate income had to be recognized because the property is used for an economic activity, even if the activity is conducted by the other spouse.

3.7 Personal income tax. - The three-year holding period for considering for personal income tax purposes that an asset is used in an economic activity only applies to assets coming out of personal property

Galician Regional Economic-Administrative Tribunal. Decision of December 23, 2021

Article 28.3 of the Personal Income Tax Law provides that an asset is not considered to be used in an economic activity if it is transferred within three years from when it started to be used.

A taxpayer who operated a bakery business contributed the assets used in his business to a company which he set up with his spouse. A portion of those assets had been acquired in relation to the business within a three year period before the contribution was made. The tax authorities made an adjustment to the deduction of depreciation of those assets in the years before they were contributed, due to considering that they were never used in the business, because they had been transferred to the new company before three years had passed.

The tribunal rejected this view adopted by the tax authorities. According to the tribunal, this three-year period for considering that an asset has been used in the business is only required for assets that come out of personal property, not to assets acquired directly when conducting the business.

3.8 Personal income tax.- Exemption for capital gain on reinvestment in principal residence in the same year as the transfer is not an electable option subject to a time limit

Castilla-La Mancha Regional Economic-Administrative Tribunal. Decision of November 16, 2021

Under the Personal Income Tax Law, a capital gain obtained on the sale of a principal residence is exempt where the amount obtained on the transfer is reinvested in another principal residence.

This decision examines the case of a taxpayer that made the reinvestment in the same fiscal year as the transfer although when preparing their personal income tax return for that year they mistakenly failed to report the exemption. When they noticed the error, they applied to correct the return and requested the relevant refund. The tax authorities denied the request because, in their opinion, applying the exemption is an electable option which cannot be modified outside the voluntary filing period.

The Castilla-La Mancha TEAR upheld the taxpayer's claim. According to the tribunal, applying the exemption is not an electable option subject to a time limit which cannot be modified after the voluntary filing period for the self-assessment, where the reinvestment is made in the same fiscal year as the transfer of the residence.

The tribunal clarified that an electable option does exist, by contrast, if the reinvestment is not made in the fiscal year of the sale but in a later year.

3.9 Transfer and stamp tax. - Exemption for transfer of shares in entities engaged in construction or real estate development may only be applied where they are the only activities in their corporate purposes

Central Economic-Administrative Tribunal. Decision of March 29, 2022

Under the Transfer and Stamp Tax Law and the Securities Market Law, the transfer of securities, either listed on an official secondary market or otherwise, is exempt from transfer and stamp tax. This exemption does not apply to the transfer of shares in companies at which at least 50% of their assets consists of properties located in Spain, or their assets include securities which allow them to exert control over another entity at which at least 50% of their assets consists of real estate. Any real estate forming part of the current assets of the entities having as their exclusive corporate purpose the conduct of business activities relating to construction or property development is not included in their assets for the purposes of calculating that 50% threshold.

For these purposes, TEAC affirmed that the term "exclusive" as referred to in the law is used with its own or usual meaning. Therefore since the term "exclusive" in Spanish is defined as "unique, excluding any other", the special rule can only be applied in relation to entities whose corporate purpose consists, only, of conducting business activities relating to construction or property development.

TEAC clarified further that a company's corporate purpose is that defined in its bylaws, and no analysis is required or needed of the company's real, substantive and actual activities.

3.10 Transfer and stamp tax. - Deed for cancellation of a condition precedent is an act subject to stamp tax

Balearic Islands Regional Economic-Administrative Tribunal. **Decision of February 24, 2022**

Article 2.2 of the Transfer and Stamp Tax Law provides that, in acts or contracts subject to a condition precedent, the tax is not assessed until the condition is fulfilled.

A taxpayer purchased a plot of land, and deferred payment of part of the price. The deferred payment was subject to a condition precedent consisting of the performance of a number of works by the seller on the plot. The taxpayer nevertheless assessed stamp tax on the agreed total price, due to considering that article 2.2 does not apply to stamp tax.

On completion of the works, a public deed was executed for "acknowledgment of deferred payment and cancellation of conditions precedent" and a new stamp tax self-assessment was filed, although the transaction was marked as exempt. The tax authorities reviewed this second self-assessment and concluded that the transaction should have been reported as non-exempt from stamp tax, and the tax should have been calculated on the deferred price.

The claimant pleaded that, because stamp tax had originally been paid on a taxable amount consisting of the total price of the transaction, paying the tax again in respect of the second deed (for cancellation of the condition precedent) gave rise to double taxation. The taxpayer moreover considered that fulfillment of the condition precedent did not qualify as a separate legal act and affirmed that for an act to be subject to stamp tax the document must reflect a contract or legal act strictly speaking, in other words, an act that gives rise to substantive legal effects.

The Balearic Islands TEAR confirmed the assessment. According to the tribunal, the fulfillment of a condition precedent gives rise to the creation at the registry of a separate entry to the main entry and therefore the deed recording cancellation of the condition is subject to stamp tax.

3.11 Administrative procedure. - A change of principle by the Supreme Court to the detriment of the taxpayer can only be applied from when it occurs

Central Economic-Administrative Tribunal. **Decision of March 23, 2022**

A judgment delivered in 2016 determined that a company was entitled to a higher amount of just compensation than was originally recognized. The taxpayer recorded this amount for accounting purposes with a charge to an account receivable and a credit to reserves, in other words, without recognizing it in income for the year. Additionally, no positive adjustment was made when determining its corporate income tax base. According to the taxpayer, it was an amount of income attributable to the fiscal year of the seizure by eminent domain (which by then was statute-barred), under the Supreme Court's case law that existed at that time.

The tax authorities, however, submitted that the Supreme Court had modified its principle in judgment no 937/2017 for a ruling on a point of law, delivered on May 26, 2017 (a principle it later reiterated). According to the new case law, the just compensation recognized in a court judgment must be recognized in the fiscal year in which the judgment becomes final and not in the year of the seizure by eminent domain.

TEAC concluded that, under the principles of legal certainty and legitimate expectations, a change of principle by the Supreme Court to the detriment of the taxpayer may only be applied from when that change occurs. In other words, adjustments cannot be made to past positions in which taxpayers applied the case law principle in force when their self-assessments were filed.

In the specific case examined, however, TEAC confirmed the tax authorities' assessment because when the 2016 corporate income tax self- assessment was filed in July 2017, the Supreme Court's change of principle was known.

3.12 Management procedure.- The time limit for enforcing economic-administrative decisions partially upholding claims and arising from management procedures is one month and failure to meet the time limit only determines that late-payment interest is not charged

Central Economic-Administrative Tribunal. Decision of March 23, 2022

Up until this decision TEAC had been holding that, where an economic-administrative claim is partially upheld for substantive reasons, and additional work by the management body is ordered, this work should be performed within the six month period determined in the law for audits, running from when the decision had been entered on the register held by the competent body for enforcement; and that the effect of a breach of that period was expiry.

Based on the principle determined by the Supreme Court in its judgment of November 19, 2020 (appeal 4911/2018), TEAC changed its earlier theory and concluded that the period available to the tax authorities to enforce a decision is one month from when the decision is received by the body responsible for its enforcement. However, the only consequence of exceeding that time period is that late-payment interest cannot be charged from when the time period was breached.

3.13 Collection procedure. - Notification of attachment to holders of rights in rem in the attached asset does not entitle them to challenge it

Central Economic-Administrative Tribunal. Decision of March 17, 2022

TEAC examined whether the usufructuary for a property is entitled to challenge an attachment on that property.

The reply was no. This does not mean that the attachment does not have to be notified to the usufructuary. According to the tribunal, the purpose of notifying the usufructuary is to enable them to lodge a claim to assert third party rights in ownership or other type civil action to safeguard their right in rem, although it does not entitle the usufructuary to challenge the attachment order or the decision to extend liability.

3.14 Collection procedure. – Against an audit of reported values performed by the tax authorities in a procedure for declaring joint and several liability, the interested party may request an expert appraisal made at the taxpayer's instance

Central Economic-Administrative Tribunal. Decisions of July 19, 2021 (0167/2019) and February 17, 2022 (0947/2019)

It was examined in these decisions whether it is correct for the tax authorities to make an appraisal in a procedure for declaration of joint and several liability made under article 42.2.a) of the General Taxation Law (in other words, as a result of cooperating with concealing or transferring assets or rights of the main debtor to prevent the tax authorities from using them in their work), without notifying the interested party of the option to request their own appraisal.

TEAC concluded as follows:

(a) If the tax authorities make an appraisal of the assets to determine the scope of the concealment, and use for this purpose any of the appraisal methods set in the LGT, they have to give the interested party the option of requesting a correction of the appraisal in an appraisal made at the taxpayer's instance.

(b) However, the taxpayer's appraisal must be requested from the start. In other words, they cannot reserve the right to request an appraisal by reason of an appeal or claim filed against the decision to extend liability. Moreover, the submission of an appraisal made at the taxpayer's instance does not stay enforcement of the decision to extend liability.

4 Resolutions

4.1 Corporate income tax.- Each company in a coordination group has to fulfill the requirements individually to consider that an economic activity exists

Directorate General for Taxes. Resolution V0647-22 of March 25, 2022

Two companies engaging in property leasing are majority owned by an individual who is also the sole director of both entities. The other shares belong to the individual's sons.

In relation to being able to consider that an economic activity exists, it was asked whether each company would have to have a person employed under an employment contract for full-time work or whether, based on the characteristics of the shareholders of these two companies, one of the companies could hire a worker devoting all of their time to managing the rentals of both companies, with both entities sharing the costs.

The DGT requested a report from the Spanish Accounting and Audit Institute. According to the Spanish Accounting and Audit Institute, this case involves a coordination group which falls outside the definition of group of companies provided in article 42 of the Commercial Code.

As a result, the fulfillment of the requirements for an economic activity to exist within the meaning of article 5 of the Corporate Income Tax Law cannot be determined from the standpoint of both entities combined, but rather each one individually.

4.2 Corporate income tax.- Dormant companies may belong to a tax group

Directorate General for Taxes. Resolution V0646-22 of March 25, 2022

A subsidiary in a tax group had become temporarily dormant. It was asked whether this circumstance affects its belonging to the tax group and the offset of any tax losses that may be or have been generated.

The DGT noted that the legislation does not provide the fact of a subsidiary being dormant as a ground preventing it from belonging to a tax group. Therefore, that subsidiary will have to continue to be part of the group.

Moreover, there is no limit on the offset of its tax losses in the tax group (except for the limits in the law for cases where the losses were generated before the company joined the group).

4.3 Corporate income tax.- Analysis of the treatment applicable to indemnification for damage to a building caused by explosion at a neighboring factory building and the works to repair it

Directorate General for Taxes. Resolution V0598-22 of March 21, 2022

An entity owns a factory building which was damaged by an explosion at a neighboring building, for which the entity received indemnification from an insurance company. After requesting a report from the Spanish Accounting and Audit Institute on the accounting treatment of that indemnification the DGT concluded as follows:

(a) The company will have to retire from its accounting records the tangible assets that are no longer usable, and recognize an expense against income.

(b) Where the asset is insured and the indemnification to be received is practically certain or assured, a revenue must be recorded in respect of the indemnification, to the extent of the loss incurred, unless the insured minimum is higher, in which case the revenue must be recorded with this second value, unless the insurer has accepted the claim. This revenue will be taxable.

After the indemnification has been received, the amount by which it exceeds or falls short of the amount previously recorded must be recognized.

In relation to the costs incurred to repair or rebuild the building, as well as its subsequent depreciation, the recognition and measurement rules in the Spanish chart of accounts must be applied together with the principles determined in the Spanish Accounting and Audit Institute's rulings dated March 1, 2013 and April 14, 2015. The tax scenarios are as follows:

(a) If the costs are classed for accounting purposes as period expenses they must be included in the tax base relating to the year in which they accrue.

(b) Otherwise, in other words, if the works involve renovation, extension or improvement of the building and therefore their cost must be recorded as added value to the asset, this cost must be depreciated for tax purposes over the remaining tax periods in its useful life.

If the works lengthen the useful life of the building, this lengthening must be taken into account for the purposes of depreciating both the original cost and the cost of the renovation, extension or improvement.

4.4 Corporate income tax.- Expense caused by a scam is deductible if the facts can be evidenced

Directorate General for Taxes. Resolution V0674-22 of March 29, 2022

An entity was the victim of a scam on the Internet. After it had paid the price of goods advertised online, the goods were not delivered. Moreover, the Spanish civil guard police force informed that it is a widespread scan and that it is unlikely they will recover the money paid.

According to the DGT, a one off expense caused by the theft experienced by the entity may be deducted, if the facts can be substantiated. If the stolen amounts are later recovered or the purchased good is delivered, a revenue must be recorded which will be computable in the tax base.

4.5 Personal income tax.- Analysis of the tax on overall per diems that are not divided into living and accommodation expenses

Directorate General for Taxes. Resolution V0493-22 of March 10, 2022

The collective labor agreement for a company provides for the payment of an overall per diem for employees' living and accommodation expenses without specifying which part of the amount relates to "accommodation" expenses and which to "living" expenses.

The DGT reiterated its view that these per diems may be exempt, subject to the following principles:

(a) Firstly, to be exempt in respect of per diems, amounts must be supported by a document evidencing the expense (generally the bill for the stay).

(b) The difference between the overall per diem and the per diem for a supported stay is exempt as a living expenses per diem, subject to the limits placed on these per diems in the Personal Income Tax Regulations.

(c) Any amounts over and above those exempt per diems will be taxable and not exempt.

4.6 Nonresident income tax.- Property leasing is not an industrial activity for the purpose of avoiding the taxation of capital gains

Directorate General for Taxes. Resolution V0464-22 of March 10, 2022

A Swiss resident individual transferred an ownership interest in a Spanish resident company. More than 50% of the value of this entity comes from properties (real estate) located in Spain. Those properties are leased out, and the company has an individual working full time under an employment contract who devotes all their time to this activity.

Under the Spain-Switzerland tax treaty, the capital gain obtained from that transfer could be taxable in Spain because more than 50% of the transferred shares are (directly or indirectly) from immovable property located in Spain, unless the property is used for the company's industrial activity.

Neither the treaty nor the nonresident income tax legislation (or the personal income tax legislation to which the nonresident income tax legislation refers) contain a definition of "industrial activity". However, the definition of "industrial activity" in the legislation on the tax on economic activities may be used.

According to TEAC's principle as determined in decision 00-4009-17 (dated February 26, 2020), in the tax on economic activities classifications the following divisions are connected with industrial activities (i) energy and water, except for power plant clusters for electricity generation, (ii) extraction and processing of non energy minerals and derivatives of chemicals, (iii) metal processing industries (precision mechanics) and (iv) other manufacturing industries.

The DGT concluded that property leasing does not fall within any of the divisions described above. Consequently, any capital gain obtained on a transfer of the company's shares may be taxed in Spain.

4.7 Transfer and stamp tax. – Transfer and stamp tax must be self-assessed using the reference value, even if it is higher than the sale price, although it may be contested later

Directorate General for Taxes. Resolutions V0453-22 of March 9, 2022, and V0689-22 of March 30, 2022

Law 11/2021 of July 9, 2021 on measures to prevent and combat tax fraud (see our commentary dated July 10, 2021) provided that the taxable amount for transfers of real estate assets consists of the reference value, unless the consideration or reported value are higher.

In relation to this modification, the DGT set the following guidelines:

(a) The reference value is also applicable for transfers of properties made by public, notarial, judicial or administrative auction. If no reference value exists or the reference value cannot be certified by the Directorate-General for the Cadaster, the provisions in article 39 of the transfer and stamp tax regulations apply, according to which the acquisition cost of the property will be taken as the market value.

(b) If the sale price of a residential property is restricted by the authorities, this would be its market value, and the reference value cannot be higher than that market value. If the reference value is higher than the maximum sale price and the interested party considers that the allocated value is detrimental to its lawful interests:

- The transfer and stamp tax self-assessment will have to be filed using the reference value.
- That self-assessment may be contested later.

4.8 Administrative procedure. – The legal personality of an entity cannot automatically be ignored to allocate ownership of its assets, for tax purposes, to its owner or director

Directorate General for Taxes. Resolution V0609-22 of March 23, 2022

A nonresident individual contributed various financial and real estate assets to a private foundation with separate personality formed in Curazao. This individual held founder rights, consisting of the right to decide the members of the entity's managing body, to regulate its liquidation and distribute its transferred assets. In addition to being named the foundation's primary beneficiary.

After the individual became tax resident in Spain, it was asked whether, for tax purposes in Spain, those financial and real estate assets must be considered to be owned by that individual, or conversely, that contribution to the foundation is deemed to be valid.

The DGT replied as follows:

(a) A private foundation with separate legal personality is not a trust nor can it be treated as this type of mechanism. Trusts do not have a legal personality and therefore do not own the assets or rights forming part of them, whereas if an entity has a legal personality, such as a foundation, it may have its own assets.

(b) The fact of an individual being granted power of attorney in relation to an entity with a legal personality, does not imply that the entity's assets automatically have to be attributed for tax purposes to that individual. Finding otherwise would be tantamount to denying the entity's legal personality. The case law theory of the lifting of the veil, the DGT went on to explain, does not imply that the entity's legal personality is ignored.

All of the above is without limitation to the possibility that, if certain circumstances are met, the tax authorities may use the rules on sham transactions or conflict in the application of tax provisions to make a correct classification of the facts, acts and transactions.

5 Legislation

5.1 New form 490 approved for self-assessment of the tax on certain digital services

The May 31, 20222 edition of the Official State Gazette published Order HFP/480/2022 of May 23, 2022 approving the new form 490 for "Self-assessment of the tax on certain digital services" and determining the manner and procedure for filing it.

The new form includes the effects of the agreement on the tax with the Basque Country (see our Alert).

This order comes into force on June 1, 2022 and will apply for the first time to self-assessments relating to the second quarter of 2022 for which the filing period starts on July 1, 2022.

5.2 Reduction of the net income indexes applicable under the personal income tax objective assessment method for agricultural and livestock farming activities

The May 11, 2022 edition of the Official State Gazette published Order HFP/413/2022 of May 10, 2022, reducing the net income indexes for the 2021 tax period and modifying the correction multipliers for animal feed purchased from third parties and for crops grown on land irrigated using electric power, applicable in the personal income tax objective assessment method for agricultural and livestock activities affected by various exceptional circumstances.

5.3 Corporate income tax return forms for fiscal year 2021 have been published

The May 4, 2022 edition of the Official State Gazette published Order HFP/379/2022 of April 28, 2022 approving the corporate income tax return forms and nonresident income tax return forms for permanent establishments and for pass-through entities created in other countries but with presence in Spain, for the taxable periods commenced between January 1, 2021 and December 31, 2021.

In the same order instructions are issued in relation to the filing and payment procedure, and the general conditions and procedure for electronic fling are defined.

The filing period runs until July 25, 2022 if the taxpayer's fiscal year is the same as the calendar year (July 20 if payment by direct debit is chosen).

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