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TAX NEWSLETTER

GARRIGUES

Latest developments and legal trends - Legislation of interest

News Roundup - Judgments

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1. An expense (or lower amount of income) arising from a rent reduction is deductible for corporate income tax purposes

Stalled economic activity as a result of the health crisis is prompting renegotiations of commercial lease agreements due to force majeure, and reductions or deferrals are similarly being negotiated for many other contracts or activities. Here is how we recalled this in our Commentary on April 11 (see here).

This context has placed in the spotlight the recent national appellate court judgment of January 27, 2020 (appeal 466/2016), examining the case of a company that had signed a hotel lease, as lessor, entitling it to receive an annual amount of rent payable monthly in advance. Due to the difficulties that the lessee was experiencing, they reached an agreement forgiving the rent for various months, on condition that the lessee continued with the lease and, if its business improved in a later year, it would pay the forgiven amounts.

The forgiven rent payments were recorded in invoices correcting those originally issued for the months qualifying for the agreed terms; which entailed a reduction to the lessor's income and a reduction to the lessee's expenses, for accounting and corporate income tax purposes. The agreement was also mentioned in the lessor's notes to financial statements and accounting records.

The tax authorities took the view that the described events in actual fact were defaulted debts, which should have led the lessor to record a provision for bad debts that would not have been deductible for the lessor because fewer than six months had run between when the default occurred and the year-end. The taxpayer argued, however, that this involved a contract novation granted to keep the lease agreement alive, giving rise to a deductible expense.

The National Appellate Court concluded that:

a) Price is one of the essential elements of a lease agreement, meaning that any change to it implies the existence of a termination novation (article 1203 of the Civil Code). Novation agreements of this type are not subject to any particular requirements as to their form, so tacit novation is presumed if it can be inferred from actions with an unambiguous meaning such as, in this case, issued correction invoices, entries in the accounting records, and a mention in the notes to financial statements.

b) Therefore, what we have is not a default, instead a meeting of minds that implies a price reduction, such that the creditor would not be able to charge the reduced price without the debtor's consent. The only way to conclude that a default has occurred is by categorically denying the very existence of the forgiveness, discount or reduction agreement that gave rise to the issuing of correction invoices; and this is not possible based on the items of evidence mentioned.

In short, the agreement they reached does not imply a default (or a deferral), because the debt claim does not depend exclusively on a decision by the creditor, due to requiring a new agreement expressing the debtor's intention to pay the forgiven sums.

c) A gift has not occurred either, because the unilateral nature required for gifts is not present; there is an agreement between the parties, which leaves open the option of another later agreement amending the terms and conditions of the previous one.

Therefore, the ability to deduct the expense (or lower amount of income) recorded by the lessor due to the agreement reached between them cannot be denied.

2. Judgments

2.1 Corporate income tax.- The only requirement to claim the regime for companies of a reduced size was the net revenues threshold (under the former Corporate Income Tax Law)

Supreme Court. Judgment of March 11, 2020

A company engaged in property leasing claimed the regime for companies of a reduced size in the fiscal years between 2008 and 2011. The tax authorities concluded that the regime could not be claimed in those years because the company had not carried on any real economic activity, since it had not been evidenced that it had premises for carrying on its activity and at least one person employed full time under an employment contract.

The Supreme Court examined the requirements that must be met by a company engaged in property leasing to be eligible for the tax incentives for companies of a reduced size under the former Corporate Income Tax Law (TRLIS), then in force. It examined in particular whether:

- those incentives could be made conditional on the existence of a real economic activity, within the meaning of article 27 of the Personal Income Tax Law, not laid down as a legal requirement at that time (although it is in the current law); or

- it is enough for the net revenues figure to be below the legally specified limit, the only legal requirement laid down in the TRLIS.

The Supreme Court confirmed its earlier theory (in a judgment delivered on July 18, 2019, analyzed in our August-September 2019 Newsletter) by concluding that in the examined years the regime for companies of a reduced size could not be made conditional on the existence of a real economic activity (within the meaning of the personal income tax legislation), because the TRLIS did not expressly contain this requirement.

2.2 Personal income tax.- Benefits under a group insurance policy taken out before 2007 and tacitly renewed annually qualify for reductions under the transitional regime

Supreme Court. Judgment of March 3, 2020

The Personal Income Tax Law in force until December 31, 2006 characterized retirement and disability pensions under group insurance policies funding companies' pension obligations as salary income, with the right to certain reductions if they were received in a lump sum. The current law has retained that characterization but does not allow reductions of this type, although it contains a transitional arrangement (transitional provision eleven), allowing the reductions to continue for any taxpayers receiving benefits under group insurance policies taken out before January 20, 2006.

In the case examined in this judgment, the group insurance policy was renewed annually. It was considered whether this annual renewal entails an extension of the original contract (which would allow the transitional regime to be claimed) or, conversely, involves an annual termination novation, which would prevent entitlement to the regime.

The court concluded that each specific case needs to be examined to conclude as to whether the renewals terminate or amend the contracts. It found that the specific case under examination involved an annual amendment novation, not altering the essential terms of the contract, which allows the original contract date to be kept, and with it, the right to the reductions under the transitional arrangement.

2.3 Personal income tax.- Directors can claim exemption for work performed abroad

National Appellate Court. Judgment of February 19, 2020

The personal income tax rules allow an exemption for work performed abroad. The DGT has been finding that this exemption is only available for anyone obtaining salary income under an employment relationship, in other words, that it is not claimable by anyone having a contract for services. Therefore, the exemption cannot be claimed by the directors of any type of entity. This even applies to the income received by directors for their executive duties not simply for belonging to the managing body, under the prevailing relationship theory.

In the case examined in this judgment, the tax authorities had disallowed the exemption on the basis of that theory.

The National Appellate Court, however, held that the interpretation supported by the tax authorities was not correct for the following reasons:

a) The aim of the rule is to encourage international deployment of human capital, by reducing the tax pressure on Spanish residents who temporarily relocate to work abroad.

b) The article specifies that the following is exempt: “salary income for work performed abroad". Therefore, the rule does not exclude from its scope any of the types of salary income defined as such in the law itself, including salary income under a contract for services (provided the income does not qualify as income from economic activities) and, specifically, the income of directors.

c) Therefore, if the other requirements laid down for the exemption in the rule are met, directors cannot be disallowed from claiming the exemption.

It must be remembered that the Supreme Court admitted appeal number 1990/2019 in a decision rendered on November 21, 2019, in which this issue will be examined although related to Spanish resident directors' participation in nonresident companies, so the case to be examined in that appeal is not the same as that analyzed by the National Appellate Court. The specific question raised in the Supreme Court case is whether the exemption "can be claimed in respect of income for management and control associated with participation in the board meetings of a subsidiary abroad or, conversely, those activities do not qualify as effective work or therefore give entitlement to the exemption under the article mentioned above".

2.4 Personal income tax.- Rejection of exemption for a severance payment must be based on solid and consistent evidence, even if it is indicative

National appellate court judgment of January 22, 2020

In a tax audit on a company, the auditors recharacterized a dismissal as termination by mutual agreement, which meant rejection of the exemption included for calculating the tax withheld from the severance paid by the company.

The tax authorities' reassessment was based, as has become customary, on certain items of circumstantial evidence, which the National Appellate Court found insufficient in this judgment.

Namely, it held that the fact of the letter of dismissal and acceptance of the severance having simultaneous dates or of the agreed severance being below the statutory amount in the Workers' Statute is not sufficient evidence of the existence of a mutual agreement. This, in the court's view, may result from a negotiation over the amount of severance (not over the dismissal) aimed at reducing the uncertainty, in particular, of the dismissed worker.

The court underlined, moreover, that the employee's retirement age was a long way off and that, although various dismissals with similar characteristics occurred at the company around the same time, the auditors only saw fit to reassess one of them.

2.5 Personal income tax.- Capital gains derived from awarded proceeding costs have to be reduced by defense costs

Madrid High Court. Judgment of December 02, 2019

The tax authorities took the view that the proceeding costs awarded to an individual should be taxed for personal income tax purposes as a capital gain in the general taxable income.

In this judgment, Madrid High Court held that, to calculate that capital gain, the awarded costs should be reduced by the amount of suitably supported expenses incurred in the proceeding (i.e. invoices of counsel and court procedural representative). Finding otherwise would mean taxing fictional income and breaching the aim sought by the award of costs, which is simply full recovery of the expenses incurred in the proceeding by the winning party.

It must be recalled that Murcia's Regional Economic-Administrative Tribunal had already concluded this in a decision delivered on January 11, 2019; an interpretation that is along the lines of that supported by the Ombudsman in his Recommendation of July 18, 2017 (rejected by the tax authorities).

2.6 Nonresident income tax.- The income specified in the parent-subsidiary directive does not apply for companies formed in Gibraltar

Court of Justice of the European Union. Judgment of April 2, 2020. Case C-458 /18

A Bulgarian company paid out dividends to its parent company, formed in Gibraltar, without withholding or assessing any tax at all because it considered that the exemption allowed in the parent-subsidiary directive was applicable. The Bulgarian tax authorities reassessed the tax position of the company that paid out the dividends, because they considered it should have withheld tax at source on the dividends, because the parent company was a nonresident foreign company in a member state.

The Bulgarian company considered that its parent company met the requirements to be treated in the same way as a company formed in the United Kingdom, and therefore filed a challenge against the assessment. The requesting court asked, in essence, whether the phrases "companies incorporated under the law of the United Kingdom" and "corporation tax in the United Kingdom" as used in the parent-subsidiary directive include, respectively, companies incorporated in Gibraltar and the tax on corporate income in Gibraltar.

The CJEU concluded that the parent-subsidiary directive must be interpreted to the effect that the phrases "companies incorporated under the law of the United Kingdom" and "corporation tax in the United Kingdom" appearing in it do not refer to companies incorporated in Gibraltar and subject to tax on corporate income in Gibraltar. Specifically, the CJEU rejected their consideration as such on the basis that the UK government clarified that, in its internal legal system, companies incorporated under its law only include companies considered incorporated in the United Kingdom, not companies incorporated in Gibraltar.

2.7 VAT.- Transfer by a financial institution of shares in other companies to fulfill a legal obligation is not an extension of the main financial activity, and therefore does not affect the general deductible proportion

Supreme Court. Judgment of March 2, 2020

The court examined the case of a financial institution established in the Spanish VAT area, owning shares in two financial institutions established in Andorra (a third area for VAT purposes). To fulfill the legal obligation to reduce its legal ownership interest to 51% and to combine the group's financial business in Andorra, it transferred its investment to third parties also domiciled in Andorra.

The VAT Law (article 104.Three.4) excludes "non-habitual" financial transactions from the calculation of the general deductible proportion, whereas the term used by the Directive in article 174.2 for the exclusion of such transactions is if they are "ancillary".

The Supreme Court (in line with a judgment delivered on October 9, 2015 in cassation appeal 889/2014) concluded as follows:

a) Non-habitual and ancillary do not have the same meaning. Non-habitual refers to a transaction that is infrequent or isolated; whereas ancillary refers to it being secondary to the main activity. Therefore, a transaction may be non-habitual and yet form part of the main activity. Whereas a habitual transaction may not be part of the main activity and therefore be ancillary.

b) Therefore, the financial transaction at issue is indeed non-habitual, in that it is infrequent and isolated. For the purpose of calculating the general deductible proportion under the European rules (applicable directly and with priority), however, it needs to be examined whether the transaction is ancillary.

   Although the directive does not define the meaning of ancillary transaction, the CJEU has done so in various judgments. According to the CJEU, an ancillary activity is one that is not a direct, permanent and necessary extension of the financial activity of the taxable person.

c) In the examined case, it was observed that, through the sale of shares, the bank as a whole was transferred to achieve the aim of fulfilling a legal obligation and combining the Group's financial business in Andorra. This transaction, in short, did not involve an extension of the main financial activity, nor did it entail a significant use of goods and services in terms that, according to the CJEU's case law, would preclude the ancillary nature of the transaction, which determines that the transaction cannot be included for the purpose of determining the general deductible proportion.

2.8 Transfer and stamp tax.- A property value included in a mortgage appraisal report cannot be used to identify its actual value

Valencia High Court. Judgment of January 20, 2020

The tax authorities reassessed the transfer and stamp tax on the sale of a property due to considering that the taxable amount should have been the property value as stated in the mortgage appraisal report.

Valencia High Court held, however, that the actual value of a property cannot necessarily be identified from the value determined for the purpose of applying for a mortgage, because this appraisal is made with a specific aim.

2.9 Transfer and stamp tax.- For the audit of a property value to be valid, the tax authorities have to evidence that they made at least one attempt to visit the property

Valencia High Court. Judgment of December 10, 2019

In this judgment the court voided an assessment resulting from an audit of reported values on the basis that the authorities' expert report had been drawn up without visiting the property.

The need to visit the property that is being audited in relation to its reported value continues to be the subject of debate and has given rise to differing interpretations by the Spanish courts. The dispute could be settled by the future judgment that will be delivered by the Supreme Court in cassation appeal number 5353/2019 which was admitted in a decision dated March 6, 2020.

2.10 Tax on increase in urban land value.- Deeds are valid proof to evidence a loss in value of a piece of land, even if the prices of the various properties are not itemized

Madrid High Court. Judgment of December 10, 2019

In the case examined in this judgment an assessment of the tax on increase in urban land value due on the sale of three properties had been challenged. The taxpayer provided the deeds for joint acquisition and sale of the properties as proof of the loss in value of the land relating to those properties, and therefore, of the unlawfulness of the appealed administrative decision.

However, the purchase deed did not itemize the prices allocated to the individual properties, all located on the same street and having the same use as offices. Neither deed, moreover, separated the prices of the land from those of the buildings. For these precise reasons, the tax authorities rejected the value of the provided deeds as evidence.

Finding in favor of the taxpayer's interpretation, Madrid High Court allowed the provided deeds as evidence indicating the fall in value of the land; because the tax authorities did not provide any proof refuting that it had occurred, and confirmed that the assessment was unlawful.

2.11 Tax procedure.- After an assessment has been voided on procedural grounds, the tax authorities must roll back procedure and render a new assessment decision, without being able to issue "interim assessments"

Madrid High Court. Judgment of November 4, 2019

The facts in the case examined in this judgment were:

a) The taxpayers filed an inheritance and gift tax return for a *mortis causa* transfer which included various properties.

b) Madrid autonomous community initiated an audit to examine the return, and issued an assessment based on higher values than those reported by the taxpayers. The taxpayers paid the debt determined in the assessment.

c) In a subsequent economic-administrative claim the administrative assessment was voided because, in the tribunal's view, the audit of the reported values of the properties had been conducted without the appropriate safeguards. It nevertheless ordered a rollback of procedure.

d) In its enforcement of the decision, the Madrid autonomous community:

- acknowledged the taxpayers' right to a refund of the amount they had paid plus late-payment interest;
- issued a new provisional assessment based on the asset values originally reported by the taxpayers;
- offset the acknowledged refund against the debt calculated in the earlier provisional assessment.
- ordered, lastly, rollback of the tax audit to before the examination of the reported values of the real estate assets.

In short, the issued provisional assessment was characterized as an "interim assessment" for any assessment resulting from the new audit.

Madrid High Court concluded that the tax authorities had not acted consistently with the law to the extend that, where a tax assessment is voided by a decision or judgment and a rollback of procedure is ordered, the tax authorities have to void every decision that is affected by the voided assessment, and issue a new lawful assessment resulting from a new examination or audit procedures, but they cannot issue "interim assessments" for that audit.

2.12 Review proceeding – 'res judicata principle'.- A national court is not required to apply internal procedural rules that confer finality under the res judicata principle on a court judgment contrary to European law

Court of Justice of the European Union. Judgment of March 04, 2020. Case C-34 /19

An Italian company challenged an assessment issued by the Italian tax authorities in relation to a fee, arguing that the fee was contrary to EU Law. The Italian tribunal that heard the case at first instance dismissed the challenge. The taxpayer filed a challenge with the Italian Council of State, which was dismissed and the dismissal judgment became final.

Later, the taxpayer brought civil proceedings at Corte d'appello di Roma (Court of Appeal, Rome) because it considered that the Italian state had not interpreted EU law correctly. The Corte d'appello di Roma acknowledged that the conclusion reached in the final judgment by the Council of State was incorrect and that an infringement of EU law had taken place. However, it did not order a refund of the sums incorrectly paid as a result of that decision by the Corte d'appello di Roma. For this reason, the taxpayer filed, a second time, a refund application for the sums paid over to the court that had heard the case at first instance. It was in this proceeding that various requests for a preliminary ruling were submitted to the CJEU.

Particularly notable was the request concerning whether EU law must be interpreted as requiring a national court to disapply domestic rules of procedure conferring finality on a decision, where that would make it possible to remedy an infringement of a provision of EU law. The CJEU concluded as follows:

- In the absence of EU law in this area, the system implementing the principle of res judicata is a matter for the laws of the member states, with observance of the principle of equivalence and the principle of effectiveness.

- In order to ensure both stability of the law and legal relations and the sound administration of justice, it is important that judicial decisions which have become definitive after all rights of appeal have been exhausted or after expiry of the time limits provided for in that connection can no longer be called into question. Accordingly, EU law does not require a national court to disapply domestic rules of procedure conferring finality on a judgment under the principle of res judicata.

- The CJEU underlined, however, that this conclusion does not prevent the parties concerned from being able to bring liability action against the state to obtain legal protection of their rights under EU law.

3. Decisions

3.1 Corporate income tax.- The chosen depreciation method for specific assets has to be used until those assets have been depreciated in full, transferred or forfeited

Central Economic-Administrative Tribunal. Decision of January 16, 2020

The absorbing company in a merger used a depreciation method for used property on certain acquired assets, even though the absorbed company had originally been using the straight-line method based on officially approved tables.

TEAC recalled that it is not allowed to use different depreciation methods simultaneously or successively on the same asset (except in exceptional cases and their special nature must be supported in the notes to financial statements); this is under the so-called rule on continuity of depreciation.

That rule determines that where a taxable person has chosen a given depreciation method for certain specific assets, it must continue to be used until the assets have been depreciated in full, transferred or forfeited.

TEAC concluded that this rule is equally applicable (though with a few adjustments) in a business merger, meaning that the absorbing company must retain the depreciation methods used by the absorbed company, for each type of asset.

3.2 Personal income tax.- Before December 31, 2015 "minimum amortization" did not exist for the purpose of reducing the acquisition value of intangibles with indefinite useful lives used in an economic activity

Central Economic-Administrative Tribunal. Decision of February 10, 2020.

The issue concerned whether the acquisition value of an intangible asset with an indefinite useful life used in an economic activity must be calculated by reference to its minimum amortization, even if the asset has not actually been amortized on the taxpayer's personal income tax return.

TEAC held that, under the legislation in force before January 1, 2016 (applicable to the case at issue), intangible assets with indefinite useful lives could not be amortized for tax purposes. Even though an impairment loss on them was tax deductible, that impairment loss could not be treated as "minimum amortization".

On that basis, it concluded that, for personal income taxpayers that used the direct assessment method to calculate their income from economic activities, before December 31, 2015 no "minimum amortization" existed of intangible assets with indefinite useful lives for the purpose of quantifying their acquisition value.

3.3 VAT.- Input VAT paid by holding companies is deductible if it relates to activities with billed fees

Central Economic-Administrative Tribunal. Decision of February 26, 2020.

The claimant was a mixed activity holding company owning shares in and providing services to certain subsidiaries. In the reassessed year it only billed one of its subsidiaries.

TEAC analyzed the CJEU's case law on the right to a VAT refund at holding companies, from which it is inferable that companies only supplying services to some subsidiaries, but not to others, will have a limit placed on their entitlement to a reduction.

It therefore concluded that the claimant carried on an economic activity due to the supply of remunerated services to one of its subsidiaries and another non-economic activity related to holding the investees to which it does not bill services. Therefore, the deduction of input VAT on

the overheads it has incurred to carry on its activity will have to be done using an allocation method that takes into account the economic activity and non-economic activity carried on by the company.

It held however that the input VAT on services and that on the costs billed in relation to directors' compensation were not deductible, due to not being determined clearly in the bylaws.

3.4 Collection procedure.- Failure to notify an attachment order to the co-owners of the attached assets does not render the order null and void

Central Economic-Administrative Tribunal. Decision of January 28, 2020.

The tax authorities served on a taxpayer an interlocutory order initiating enforced collection proceedings regarding a wealth tax debt. Because the debtor failed to pay the enforced debt within the payment period, the tax authorities served an attachment notice on the debtor in relation to movable assets. Against that attachment notice, the debtor filed an economic-administrative claim before the Asturias Regional Economic-Administrative Tribunal (TEAR) pleading, briefly, that it had applied for split payment of the debt and a decision had not been delivered on that application. The claim was upheld by the Asturias TEAR on a ground not pleaded by the claimant. Namely, the Asturias TEAR set aside the attachment notice on the basis that in relation to three of the four attached movable assets (current accounts and a mutual fund) there were co-owners that had not received the required notification.

Against the decision of the Asturias TEAR, the tax authorities filed a special appeal for a ruling on a point of law with TEAC which was partially upheld. In its decision, TEAC determined the following interpretation:

a) It is correct for the Asturias TEAR to analyze by its own decision issues that were not pleaded by the claimant, because they stemmed from documents in the administrative case file and did not place the claimant in a worse position.

b) It is true that the attachment notice should have been served on the persons affected by the procedure itself, not just on the taxpayer. A distinction is nevertheless needed between the validity and effectiveness of the administrative measure; the first refers to the content of the measure, and the second, to the legal effects it has as against third parties.

Seen in these terms, the notification of an attachment notice to the co-owners of the attached assets may be a necessary condition for its effectiveness, but not for its validity. In other words, the validity of an attachment will depend on its content, no matter how it was notified. Therefore, the absence of the mentioned notification does not make the notice of attachment is null and void.

c) Moreover, the denial of due process rights caused by failure to notify the attachment notice may be pleaded in relation to measures immediately following the enforcement proceeding.

3.5 Audit procedure.- Absence of reasoning and valuation in a report cannot be remedied in the assessment decision

Murcia Regional Economic-Administrative Tribunal. Decision of July 31, 2019.

A company deducted a sum in respect of compensation paid to its directors on the basis that their work was not confined to strict management of the company, because they also carry out marketing tasks that resulted in increased sales for the company.

In the report signed with disagreement, the auditors disallowed deduction of this expense in the amount that exceeded the compensation paid to one of the sales individuals at the company. According to the auditors, this last amount of compensation represented the value that the company gave to the director's marketing work, so any excess over that compensation amounted to a gift, and as such, a nondeductible expense. Although a pricing adjustment was made, the tax authorities did not use any of the pricing methods specified in article 18.4 of the Corporate Income Tax Law for pricing controlled transactions.

Later, the assessment decision confirmed the proposed assessment contained in the report, although based on the comparable uncontrolled price method under article 18.4.a) of the law, a pricing method that had not been used in the report signed with disagreement.

Murcia TEAR voided the assessment because it considered that reasoning and pricing defects in the report cannot simply be altered in the assessment decision. It nevertheless ordered a rollback of procedure to the point before the report was issued so that the tax authorities could provide proper reasoning.

3.6 Enforcement procedure.- Late-payment interest following the suspension of penalties in the judicial review jurisdiction is calculated from the day after the end of the voluntary payment period commenced on notification of the decision

Central Economic-Administrative Tribunal. Decision of March 9, 2020.

The tribunal examined the start and end dates of periods that must be taken into account to calculate the late-payment interest arising from penalties that have been suspended in the judicial review jurisdiction; and whether the period should be reduced by the number of days exceeding the two month period the authorities have to enforce the ruling in the judgment.

TEAC determined the following interpretation:

a) Late-payment interest on penalties falls due from the end of the voluntary payment period commenced on notification of the dismissal decision that exhausts the administrative jurisdiction, regardless of whether there has been suspension in the judicial jurisdiction. Therefore, in contradiction with TEAC's own earlier interpretation, the date of the judicial decision on suspension is only relevant for determining how long the suspension ordered in the administrative jurisdiction is maintained, but has no effect regarding the commencement of the period in which late-payment interest on suspended penalties falls due.

b) The period for the calculation of late-payment interest due during the suspension will end on the last day of the voluntary payment period commenced on notification of the end of the suspension or the day on which payment takes place within that period.

c) The adoption and notification of the express decision to lift the suspension beyond the specified two month period will determine that late-payment interest may not be charged in respect of the length of that delay.

3.7 Requests for preliminary rulings.- Economic-administrative tribunals cannot submit requests for preliminary rulings, but they have an obligation to ensure that EU law is applied

Central Economic-Administrative Tribunal. Decision of February 26, 2020.

In the context of a filed economic-administrative claim, a taxpayer asked for a preliminary ruling to be requested, and secondarily, for the claim proceeding to be suspended until a reply had been obtained to the request submitted by Valencia High Court in relation to the same subject at issue.

In relation to the first request, TEAC recalled that the Court of Justice of the European Union concluded in a judgment delivered on January 21, 2020 (case C-274/14) (Tax Newsletter - January 2020) that economic-administrative tribunals do not have the jurisdiction to submit a request for a preliminary ruling due to the absence of impartiality and independence.

It clarified however that this does not release these tribunals from the obligation to ensure that EU law is applied. Therefore, they have a duty not to apply national provisions that are contrary to EU law, because that obligation is incumbent on all national authorities not just the judicial authorities.

Lastly, TEAC reiterated that a suspension of the economic-administrative claim could not be ordered because the legislation only allows a proceeding to be suspended if the request for a preliminary ruling was submitted by the economic-administrative tribunals themselves (Tax Newsletter - September 2019).

4. Resolution requests

4.1 Corporate income tax.- Know-how cannot benefit from the patent box

Directorate General for Taxes. Resolution V0273-20 of February 5, 2020

A company submitted an issue for resolution concerning the transfer of *know-how* to a newly created related company and to independent third companies.

The DGT concluded in this resolution that the revenues obtained from the transfer cannot benefit from the *patent box*, a reduction for transfers of intangible assets defined in article 23 of the Corporate Income Tax Law. According to the DGT, only transfers of the intangible assets listed in paragraph one of that article are eligible for the reduction, and know-how is not one of them.

4.2 Nonresident income tax.- Mediation services are business profits

Directorate General for Taxes. Resolution V0337-20 of February 14, 2020

A company having its tax domicile in Spain received a supply of services by a Uruguayan company consisting of mediation with future clients and suppliers.

According to the DGT:

a) The income to be received by the Uruguayan company is characterized as a business profit, and as such is only taxable in Uruguay as determined by the tax treaty signed with that country.

b) As a result, the Spanish company will not be required to withhold tax from any fees that will be paid for the mediation services. It will however have to file a negative withholdings return (form 216) and the relevant annual summary (form 296).

c) In any event, the recipient of the income will have to provide evidence of its tax residence by producing a certificate of tax residence issued by the Uruguay tax authorities and make that certificate accessible to the payer, which will be valid for one year. The payer will have to keep the certificate and make it accessible to the tax authorities if they so request.

4.3 Personal income tax.- The reported value audited by the tax authorities is the acquisition value for the purposes of a future transfer

Directorate General for Taxes. Resolution V0468-20 of February 27, 2020

In an audit examining a property sale made by an individual, it was concluded that the value of the transferred property was higher than its reported value.

According to the DGT, this audited higher value will be the acquisition value for the purchaser, for the purposes of a future transfer, as concluded at the Supreme Court in a judgment delivered on September 21, 2015.

4.4 Personal income tax.- Forgiveness of a loan provided by a company to its shareholder is to be treated as a dividend

Directorate General for Taxes. Resolution V0350-20 of February 14, 2020

A limited liability company had provided a loan to one of its shareholders and was considering forgiving it.

The DGT took the view that, if forgiveness of the loan does not amount to a form of consideration for the supply of a service or good made by the shareholder, the income generated by that forgiveness must be characterized as income from movable capital arising from investment in equity, and is to be included in the savings taxable income. This income is subject to withholding tax.

4.5 VAT.- Treatment of penalties for breach of service level terms

Directorate General for Taxes. Resolution of January 21, 2020

The examined case concerned a company that signs contracts with clients under which it provides *back office* services related to certain internal processes. Those contracts stipulate certain "service level" terms, such that, where that service level is not observed as a result of errors or delays, the company faces penalties which are charged on the invoice following the date the errors or delays are identified. It is stipulated contractually that those penalties are not for restitution purposes, so they do not replace or reduce any damages for losses arising for the client.

It was asked whether these penalties should reduce the taxable amount of the taxed transaction performed by the requesting company for its clients or whether, conversely, they should be treated as separate obligations amounting to indemnification not subject to VAT.

The DGT concluded as follows:

a) The purpose of these penalties is as a deterrent in the form of pressure to secure proper compliance by the company, such that certain types of breaches reduce the amount payable by the client. That deterrent nature means they do not amount to indemnification, because their purpose is not restitution for a loss nor are they graded or quantified to make good a loss. For that reason, the contract sets them apart from damages.

b) These penalties, therefore, form an inseparable part of the service itself and, therefore, of the taxable amount of the transaction. As a result, the price of the back office services is determined by reference to those penalties (which reduce that price).

4.6 Transfer and stamp tax.- The delivery of properties to shareholders in a capital reduction is subject to capital tax only

Directorate General for Taxes. Resolution V0451-20 of February 26, 2018

A company owning two properties owed sums of money to its two shareholders. It was intended to discharge the debt by delivering the properties owned by the company in two successive transactions: (i) a capital increase with a debt-for-equity swap by converting the shareholders' debts into shares in the company; (ii) a capital reduction with repayment of the shareholders' contributions, by transferring the two described properties.

The DGT concluded as follows:

a) The capital increase is subject to but exempt from capital tax (a type of transfer tax).

b) The capital reduction is also subject to capital tax but not exempt, being taxable at 1%. The taxable persons are the shareholders and the taxable amount is the actual value of the properties.

c) Because the transactions are subject to capital tax (even though one is exempt) they cannot be subject to any other type of transfer tax (tax on transfers for a consideration) or stamp tax, because they are mutually exclusive.

4.7 Tax on economic activities.- Promoting properties to be leased is only taxable in respect of their rental

Directorate General for Taxes. Resolution V0226-20 of February 3, 2020

The requesting party, a shareholder and director of a company, intended to develop an industrial building on a piece of land they owned and subsequently to lease that building to the company. It was asked under which tax on economic activities captions the activity should be notified.

The DGT concluded, first, that the requesting party was not required to notify the property development activity for the purpose of the tax on economic activities, because the development is not carried out to participate in the production or distribution of goods or services. It added that, if a third party is hired for its construction and the requesting party does not undertake technical management of the project, the construction activity will not have to be notified either.

Once the construction of the property has finished and the property starts to be rented, it must be notified under caption 861.2 of the tax on economic activities classifications, which relates to property leasing.

5. Legislation

5.1 Approval of lower indexes for the objective assessment method for 2019 personal income tax

The April 9, 2020 edition of the Official State Gazette (BOE) published Order HAC/329/2020 of April 6, 2019, reducing for the 2019 taxable period the net income indexes applicable under the objective assessment method for personal income tax for agricultural and livestock activities affected by various exceptional circumstances.

5.2 Publication of the annual equivalent rate for second calendar quarter of 2020, for the purpose of characterizing certain financial assets for tax purposes

The April 2, 2020 edition of the Official State Gazette (BOE) published the decision of March 31, 2020, by the Office of the General Secretary for the Treasury and Financial Policy, which, as is now the custom, sets out the reference rates that will apply for the calculation of the annual

effective interest rate for the purposes of characterizing certain financial assets for tax purposes, this time for the second calendar quarter of 2020. The rates are as follows:

- Financial assets with terms of four years or less: 0.019 percent.
- Assets with terms between four and seven years: -0.208 percent.
- Assets with ten-year terms: 0.529 percent.
- Assets with fifteen-year terms: 0.682 percent.
- Assets with thirty-year terms: 1.016 percent.

In all other cases, the reference rate for the period closest to when the issuance was made will be applicable.

6. COVID-19 legislation

6.1 Central government and autonomous community legislation

Over the past month, we have seen the publication of more central government and autonomous community legislation to mitigate the economic effects of the health crisis. The following link takes you to the legislation and alerts we have posted: view here.

6.2 Local regulations

Local governments also have approved special measures deferring or even reducing a few local taxes, as we reported in our alert on March 27 (view here).

One of the most prominent measures in the past month was the bill by Madrid city council proposing amendments to the tax rules on real estate tax and the tax on economic activities, proposing, for 2020, 25% reductions in each tax where certain requirements are met.

We discussed this measure in our Tax Alert dated March 30, 2020.

6.3 Other legislation of interest

COVID-19: The use of the CL@ve PIN system for paying debts with credit or debit cards has been brought forward to June 1, 2020.

The April 21, 2020 edition of the Official State Gazette (BOE) published the Decision of April 15, 2020, by the Directorate General of AEAT (the Spanish Tax Agency), to allow credit and debit cards to be used for payment of tax debts.

A decision dated March 11, 2020 allowed credit or debit cards to be used for payment transactions made on AEAT's website, where the person liable for payment is an individual and accesses the website using the non-advanced electronic signature system with a password obtained in an earlier user registration (Cl@vePIN system). The decision allowed this option to take effect for payments on AEAT's website on or after June 15, 2020.

As a result of the exceptional situation caused by the health crisis, however, in a decision dated April 15, 2020 this payment option was brought forward to become available on June 1, 2020.

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