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TAX NEWSLETTER

GARRIGUES

Latest developments and legal trends - Legislation of interest

News Roundup - Judgments

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1. Spanish courts start overturning penalties related to form 720

A Castilla y León high court judgment has rendered the penalties imposed on a taxpayer null and void.

For a number of years, taxable persons owning assets and rights abroad have had the obligation to file an information return (form 720). The first return was filed in 2013, in relation to the assets and rights owned by taxable persons as of the 2012 year-end.

Procedural penalties may be levied for not filing or filing the returns late (per item of information or set of items of information not reported or reported inaccurately); and additionally the value of any unreported assets may be treated as an undisclosed increase in assets and rights for personal income tax purposes (or unreported income for corporate income tax purposes). The economic effect may therefore end up being as high as the value of the foreign assets themselves, after adding to the tax on those types of income the penalty set out for these cases, amounting to 150% of the liability for those taxes.

The disproportionate nature of this penalty system has been examined by the European Commission, which, in November 2015, sent a letter of formal notice to the Spanish authorities on the possible incompatibility of this system with EU law. Later, in February 2017, the Commission issued a reasoned opinion concluding that Spain has breached its obligations under articles 21, 45, 49, 56 and 63 of the Treaty on the Functioning of the EU and articles 28, 31, 36 and 40 of the European Economic Area Agreement. In the opinion, the Commission calls on Spain to adopt the necessary measures to adapt its legislation in two months from its receipt, a call which, until now, had not been heeded.

The Spanish courts now appear to be making a move after a judgment rendered on November 28, 2018 in which Castilla y León High Court concluded that the penalties for the late filing of form 720 are null and void as a matter of law. The court underlined that these penalties are disproportionate where the taxpayer files the return voluntarily, even if it is late, and added that it is not allowable either to impose penalties automatically without mentioning the European Commission proceeding, which had already started when the penalty was imposed.

Interestingly, the court observed a defect in the penalty proceeding because it was commenced outside the three month period envisaged in the law which is calculated from when the fact triggering the infringement was known.

2. Judgments

2.1 VAT.- CJEU clarifies how to calculate deductible VAT on costs incurred by a branch for the benefit of its head office

Court of Justice of the European Union. Judgment of January 24, 2019, case C-165/17

A judgment by the Court of Justice of the European Union (CJEU) examined the deductible proportion of VAT for a fixed establishment located in a member state on the services provided to its head office located in another member state and on any of the establishment's costs that were incurred for both its own activities and those of the head office.

According to the court, the deduction must be calculated using a deductible proportion as follows:

(a) In relation to the expenditure of the fixed establishment which is used for both taxed transactions and VAT-exempt transactions carried out by the establishment, the deductible proportion must be calculated as a fraction, having:

- As numerator, the transactions carried out by the head office (and using the costs incurred by the fixed establishment) which are deductible if carried out in the member state where the fixed establishment is registered.

- As denominator, the turnover (not including VAT), resulting from the transactions carried out by the head office and using the costs incurred by the branch.

(b) Regarding the establishment's overheads, which contribute to both the fixed establishment's transactions and to the transactions of the head office:

- As numerator, both the taxed transactions carried out by the establishment and the taxed transactions carried out by the head office which also are deductible if they are carried out in the state where the establishment is registered.

- As denominator, the transactions carried out by both the establishment and the head office.

2.2 Administrative procedure.- Delay in deciding a contradictory expert appraisal procedure does not mean acceptance of the taxpayer's valuation

Supreme Court. Judgment of January 17,2019

The Supreme Court examined a case in which a procedure to submit a contradictory expert appraisal was initiated after being applied for by the person with tax obligations, who filed the relevant appraisal report with the application. The authorities failed to deliver their decision within the time limit and to produce the appraisal contradicting that produced by the person with tax obligations.

The Supreme Court recalled that a contradictory expert appraisal, even if initiated by a person with tax obligations, is an administrative procedure for management, collection and audit of taxes, and therefore the tax authorities have an obligation to decide within six months.

It clarified, however, that the tax authorities' failure to meet the time limit does not mean that the appraisal by the expert relied on by the person with tax obligations prevails or is confirmed as a result of approval by administrative silence.

2.3 Administrative procedure.- Where the tax authorities have been using email to send notices, they must carry on using them in later communications

Catalonia High Court. Judgment of June 15, 2018

In the examined case, the authorities had been sending notification notices to the person with tax obligations by email to their enabled electronic address. They failed to send that notice in relation to one notification, however, resulting in the taxable person not opening it in the time limit.

In this context, Catalonia High Court held in this judgment that the sending of notification notices by email gave the taxable person legitimate expectations that later notifications would also be accompanied by email notices. Therefore, the notification made to the person with tax obligations without sending a prior notice must be held defective.

3. Decisions

3.1 Corporate income tax .- Accelerated depreciation may only be elected in the statutory filing period for the return

Central Economic-Administrative Tribunal. Decision of February 14, 2019

As part of a limited review procedure, a taxpayer requested recognition of a downward adjustment to the corporate income tax base, by claiming the benefit related to accelerated depreciation (which had not been included on the return filed in the voluntary period). The tax authorities rejected that request.

The Cantabrian TEAR (Regional Economic-Administrative Tribunal) upheld the taxpayer's arguments and concluded that accelerated depreciation includes exercising a right that the taxable person is allowed to exercise within the statute of limitations or nontollable time period, not an election governed by article 119.3 of the General Taxation Law.

In a special administrative appeal for a ruling on a point of law lodged by AEAT, TEAC ruled against the interpretation expressed by the Cantabrian TEAR and confirmed the tax authorities' view, by holding that accelerated depreciation is an election that may only be exercised within the statutory period for filing the tax return.

TEAC argued that if a taxable person decides not to claim the accelerated depreciation benefit for certain assets and/or rights on the return for a fiscal year, that election cannot later be changed with respect to that year. It clarified however that this argument does not mean the taxpayer cannot enjoy that tax benefit in later years, even if the accelerated depreciation in those other years relates to the same assets and/or rights.

3.2 Transfer tax.- Charging transfer tax on capital increases is precluded by EU law

Central Economic-Administrative Tribunal. Decision of January 21, 2019

TEAC examined the case of a taxable person acquiring control of a company by subscribing to a capital increase made by the company in 2010.

The tax authorities assessed transfer tax under the provisions then set out in article 108 of the Securities Market Law, because more than 50% of the entity's assets consisted of properties located in Spain and subscription to the capital increase had enabled the taxable person to take control of the entity.

The taxable person pleaded against this that Directive 2008/7/CE concerning indirect taxes on the raising of capital restricts the ability of member states to levy indirect taxes on certain transactions which raise capital, including issuing and subscribing to shares in limited liability companies, and expressly determines that the tax on those transactions cannot under any circumstances go above 1% of the value of the issued capital.

Recognizing the direct enforceability and prevalence of EU law, TEAC set aside the tax authorities' assessment by arguing that article 108 of the Securities Market Law (in the wording applicable when the taxable event took place) was precluded by the provisions in the Directive relating to the tax on transactions on the primary market (meaning legal transactions that do not strictly transfer, but relate to capital and enable new individuals or entities to take control).

3.3 Transfer and stamp tax.- The tax base for early exercise of a call option under a finance lease is the exercise price

Central Economic-Administrative Tribunal. Decision of January 21, 2019

According to TEAC, in the event of early exercise of the call option under a finance lease agreement, the tax base is not the residual value or market value of the asset under the finance lease, but the value of the legal transaction documented in the deed, in other words, the price set between the parties to acquire ownership of the asset thereby ending the financing covenanted earlier.

In short, the tax base is the price covenanted for exercising the option.

3.4 Inheritance and gift tax.- If an heir dies without accepting an inheritance only one taxable event occurs

Central Economic-Administrative Tribunal. Decision of December 10, 2018

In line with the interpretation set by the Supreme Court in its judgment of June 5, 2018 (Tax Newsletter - June 2018), TEAC has changed its earlier view and held that in cases where an heir dies before accepting an inheritance, a single inheritance takes place between the first deceased and the successor to the deceased heir.

Accordingly, inheritance tax will only fall due once.

3.5 Management procedure.- Misuse of a limited audit procedure does not render the audit null and void as a matter of law

Central Economic-Administrative Tribunal. Decision of January 16, 2019

TEAC examined the consequences of misuse of a limited audit procedure.

The tribunal concluded first that misuse of this procedure does not render the administrative acts arising from it null and void, unless it is determined from the start of the procedure that there is an outright, obvious, clear and ostensible breach of the rules of law governing it

Therefore, generally speaking, where an assessment is set aside on the ground of misuse of a limited audit procedure, the authorities may start a new review procedure and make a new assessment under the right procedure, within the statute of limitations period.

However, in any new assessment issued after the start of a second procedure, late-payment interest may only be assessed until the date on which the first assessment was set aside.

3.6 Administrative procedure.- Two contradictory attempts at notification are not valid

Central Economic-Administrative Tribunal. Decision of January 16, 2019

The tax authorities made two attempts at notifying a decision on mandatory inclusion of a taxpayer on the enabled electronic address system. In the first attempt, the postal service reported that the person with tax obligations was absent; in the second, that the taxpayer was unknown. After a third attempt, the decision was received by a person who failed to provide correct identification, and the signature and taxpayer identification number given were illegible.

A few months later, the tax authorities requested through their website a certain item of information relating to corporate income tax. Because the information was not delivered, proposed assessments and penalties were issued which were later confirmed. Later on, because the debts were not paid, enforced collection decisions were issued. Lastly, because no attention was paid to those decisions, the authorities ordered the offset of the enforced debts against a number of sums payable to the taxpayer by the tax authorities.

Only after all these steps did the taxable person enter the website and accept notification of all the decisions mentioned (assessment, penalty, enforced collection, offset). The Catalan TEAR disallowed the subsequent claim due to falling outside the time limit.

TEAC, however, concluded that the original notification attempts for the decision on inclusion on the enabled electronic address system were not valid:

(a) The first two notification attempts were contradictory, because if the taxable person was absent at the first notification attempt, they could not be unknown at the second. Besides, because no notice of those attempts was left in the mailbox, they cannot be regarded valid.

(b) The third attempt was not valid either because of the described circumstances regarding the person that received them (illegible taxpayer identification number and signature).

As a result, notification of the decision did not take place until the person with tax obligations entered the website for the first time. And for this reason, moreover, any steps by the authorities made available to the person with tax obligations on the website before the date when the taxpayer entered it for the first time, had to be disregarded.

3.7 Collection procedure.- Individual enforcement action may be commenced after the insolvency proceeding has ended if new assets or rights belonging to the debtor appear

Central Economic-Administrative Tribunal. Decision of January 30, 2019.

A commercial court rendered a decision holding that an insolvency proceeding had ended due to the inexistence of assets or rights belonging to the debtor. Later, AEAT ordered attachment of the taxpayer's bank accounts for an amount equal to the principal of an outstanding tax debt, plus the relevant enforced collection surcharge and late-payment interest.

The insolvency practitioners objected to that attachment, and the Catalonia TEAR rendered a decision upholding the filed economic-administrative claim by arguing that after an insolvency proceeding has been held to have ended due to the existence of assets and rights owned by the insolvent debtor, the creditors may take individual steps against the debtor company.

Due to disagreeing with that decision, AEAT lodged a special appeal for a ruling on a point of law, which was upheld by TEAC in a decision setting the following interpretation: after the court decision ending the insolvency proceeding has been rendered due to liquidation or insufficient assets of the insolvent debtor company, if new rights or assets owned by the debtor have appeared, creditors with claims that had been recognized but not been paid in full may bring individual enforcement actions against those new assets until a decision reopening the insolvency proceeding is rendered.

4. Rulings

4.1 Personal income tax.- DGT clarifies the personal income tax treatment for a property lease with a call option

Directorate General for Taxes. Ruling V3139-18, of December 11, 2018

A lease with a call option on a property gives rise to the following types of income:

(a) Income arising from the lease which is treated as income from movable capital for the lessor or from an economic activity, as applicable.

(b) The grant of a call option to the lessee generates a capital gain for the lessor/grantor which must be included in the general component of taxable income for the period in which the option right is executed.

(c) The transfer of the property as a result of exercising the call option gives rise to a new capital gain which must be recognized in the period when the call option is exercised and must be included in the savings component of taxable income. If it has been covenanted that the income arising from the lease of the residence and the price of the option received by the grantor must be discounted from the aggregate price agreed for the transfer, those sums must be subtracted from the transfer value of the property when calculating the capital gain or loss.

4.2 Personal income tax.- Acquisition of treasury shares is taxed as withdrawal of shareholders

Directorate General for Taxes. Ruling V3133-18, of December 11, 2018

The ruling request came from the owner of shares in an unlisted Spanish corporation (*sociedad anónima*) which were going to be transferred to the company itself. The shares were going to be held by the company as treasury shares, or in other words they would not be redeemed.

The DGT adopted TEAC's interpretation to conclude that the definition of shareholder withdrawal as used in the Personal Income Tax Law is not restricted to the definition of shareholder withdrawal in corporate law, instead it covers every case where the shareholder ceases to have shareholder status at the company, including any acquisition of treasury shares by the company which does not involve redemption of the shares through a capital reduction.

For that reason, in the examined case a capital gain or loss for personal income tax purposes will arise which must be calculated under the rules set out for shareholder withdrawal.

4.3 Transfer tax.- If the transfer is not documented, the tax will fall due when the return is filed

Directorate General for Taxes. Ruling V3126-18, of December 5, 2018

More than 20 years ago the sale of a property took place, which was not documented in writing or reported for transfer tax purposes. It is now intended to document the transfer to change the owner of the property at the Property Registry.

The transfer tax legislation provides that in transfers for consideration the tax falls due on the date the taxed transaction or agreement takes place and that, for the purposes of the statute of limitations, "on agreements not recorded in a document, it shall be presumed … that their date is the date when the interested parties comply with the provisions in article 51. The date of the private document prevailing for the purposes of the statute of limitations, according to this article determines the applicable legal treatment for the required assessment in respect of the transaction or agreement included in it". That article 51 of the Transfer Tax Law lays down the obligation to file the documents containing the taxable events.

Because in the examined case there was no private transfer document when the transfer took place, the taxable event for transfer tax purposes takes place on the date when the interested parties meet their obligation to assess the tax. This date is the date prevailing for the purposes of the statute of limitations and the date that will determine the legal regime applicable to the required assessment. That is also the date for the actual value of the asset under the reported transaction.

4.4 Inheritance and gift tax.- DGT recognizes that autonomous community legislation may be applied to the estate of a deceased resident of a third country

Directorate General for Taxes. Ruling V3151-18, of December 11, 2018 and ruling V3193-18, of December 14, 2018

Following the judgment by the Court of Justice of the European Union (CJEU), on September 3, 2014, the inheritance and gift tax legislation was amended to allow, in relation to the estate of a deceased resident of the European Union or of the European Economic Area, Spanish-resident heirs to be able to apply the relevant autonomous community legislation. This amendment, however, did not include cases where the deceased was resident in a third country.

The DGT has recognized that this legislation is contrary to the principle of the freedom of movement of capital, enshrined in article 63 of Treaty on the Functioning of the European Union, and therefore, under the principle of the primacy of European law and its direct effect on domestic law, the DGT confirmed that the legislation of the autonomous communities where the heirs are resident could be applied in the cases of two estates where the deceased were resident in Andorra and the Russian Federation.

5. Legislation

5.1 A number of forms for the tax on hydrocarbons have been amended or eliminated

Order HAC/135/2019 of January 31, 2019, amending certain orders relating to the special manufacturing taxes, the tax on retail sales of certain hydrocarbons and VAT, was published in the Official State Gazette on February 16, 2019.

To be noted in relation to the **tax on hydrocarbons**:

(a) The amendment of self-assessment form 581 and the elimination of form 582, following the elimination by the General State Budget Law for 2018 of the autonomous community rate for assessment periods commencing on or after January 1, 2019. Forms 581 and 582 in force until December 31, 2018 will be maintained to allow late, additional or correction returns to be filed in relation to tax periods before 2019.

(b) The elimination of form 564 (after five years have run from the end of the assessment periods for the tax on hydrocarbons which were self-assessed on that form).

(c) The introduction of various technical adaptations in relation to the new exemption case introduced by Royal Decree-Law 15/2018, applicable to transactions for production and imports of hydrocarbons to be used in the generation of electricity at heat power stations or in the cogeneration of power and heat at combined stations.

5.2 Urgent measures approved to mitigate the damage caused by storms and other catastrophes

Royal Decree-Law 2/2019 of January 25, 2019 adopting urgent measures to mitigate the damage caused by storms and other catastrophes occurred in 2018 and adding to the measures previously adopted in decisions by the Council of Ministers dated September 7, October 19 and November 2 2018 was published in the Official State Gazette on January 26, 2019. The royal decree-law itself states that these measures may be applied to any similar events taking place until March 31, 2019 if this is declared by royal decree, after delineating the affected areas.

The envisaged measures include a number of tax benefits such as (i) exemption from real estate tax payments for homes; industrial, tourist, trading, shipping/fishing or professional establishments; crop, livestock and forestry farms; and work premises that have been damaged, where the

individuals and assets using them have had to be fully or partially re-accommodated; or (ii) a reduction to the tax on economic activities for similar reasons (damage to premises or assets used for the business that have made it necessary to re-accommodate or temporarily close the business).

Relief is also provided (a) from the fees charged by the traffic authority for removing vehicles from the register or issuing duplicate driving licenses or vehicle registration certificates; or (b) from personal income tax for the exceptional aid for personal injury envisaged in the royal decree-law itself.

Specifically for farming activities a reduction is provided in the net income indexes for the personal income tax objective assessment method and for the simplified special VAT scheme.

This instrument came into force on January 26, 2019.

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