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GARRIGUES

Latest developments and legal trends - Legislation of interest

News Roundup - Judgments

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1. Offering stock options generates deductible expense at employer, even if offeror is the parent company

For many years, a long list of multinational groups have offered share-based incentives to their employees. In this context the compensation is often paid by an entity (the entity offering the incentive, which is usually the group's parent company) that is not the employer. Sometimes the payer (parent company) does not charge the cost of the compensation to the subsidiary employing the worker.

In ruling V2197-18, dated July 24, 2018, the Directorate-General for Taxes examined exactly this case involving a French parent company that had implemented plans awarding shares at no cost to certain senior managers and salaried employees of the various companies belonging to the group, including employees of a Spanish subsidiary. On this occasion, the French parent company did not charge any cost in respect of these plans to its subsidiaries.

Starting out from the standard determined by the Spanish Accounting and Audit Institute (ICAC), the Directorate-General for Taxes concluded that the Spanish subsidiary had to recognize a personnel expense for accounting purposes by recording it in equity, at the reasonable value of the equity instruments of its employees as of the date of the grant agreement, even if the French parent company does not bill the costs of the plan to it.

Even though that expense will not be deductible when it is recognized, it will be when the award of the equity instruments by the French company to the employees takes place.

Although it falls outside this ruling, it must be remembered that even though the payer of the income will be a nonresident entity other than the employer, the withholding tax will have to be deducted and paid over by the Spanish subsidiary, because it is an item of compensation paid by a controlled company.

2. JUDGMENTS

2.1 EU law/questions of interpretation.- National courts have obligation to refer questions of interpretation of the Treaty on the Functioning of the European Union

Court of Justice of the European Union. Judgments of September 20 and October 4 2018, cases C-685/16 P and C-416/17.

In two recent judgments, the CJEU has again held to be contrary to EU law, two tax regimes establishing discriminatory treatment in relation to the taxation of dividends from other member states or from third states.

For our purposes here, the judgments contain two particularly important findings:

(i) In one of these, the CJEU reiterates that a general presumption of fraud or abuse cannot justify a measure which prejudices the enjoyment of a fundamental freedom guaranteed by the Treaty on the Functioning of the European Union (TFEU), and the mere fact that the company distributing the dividends is located in

a non-member state cannot set up a general presumption of tax evasion (September 20 judgment).

(ii) In the other, the CJEU recalls that, where there is no judicial remedy against the decision of a national court, that court is in principle obliged to make a reference to the Court (within the meaning of article 267 TFEU) where a question of the interpretation of the TFEU Treaty is raised before it. This is intended to prevent a body of national case law that is not in accordance with the rules of EU law from being established in any of the member states (October 4 judgment).

2.2 State aid.- A tax is an integral part of state aid where it is collected exclusively and fully to grant the aid

Court of Justice of the European Union. Judgment of September 20, 2018, case C-510/16

The European Commission held to be compatible with the internal market several aid programs for the film and audiovisual industry established by France. Those programs were mainly financed through three taxes. The amounts ultimately collected from those taxes were more than 20% above the projections notified by France to the European Commission in relation to authorization of the aid.

In this context, a request for a preliminary ruling was submitted to the CJEU as to whether in the described scenario, an existing type of state aid has been amended and whether, under Regulation No 794/2004 and article 108.3 TFEU, that amendment should have been notified to the European Commission. The CJEU gave an affirmative reply to both questions, on the basis of the following arguments:

(i) The three taxes are an integral part of the state aid described, insofar as the whole of the collected amount goes exclusively towards the grant of that aid.

(ii) It is not an inescapable requirement for the increase in the collected amount to be due to a legal amendment of the state aid program.

2.3 Personal income tax.- Maternity benefit is exempt from personal income tax

Supreme Court. Judgment of October 3, 2018

The Supreme Court has put an end to a discussion over the personal income tax exemption for maternity benefits, following conflicting views from the high courts, through a judgment rendered on October 3, 2018, as discussed in our tax alert: Alerta Tributario 14-2018.

The Supreme Court concluded that the maternity benefit funded by the Spanish Social Security Institute falls within the exemption envisaged in the Personal Income Tax Law for "other public benefits for birth, multiple birth or adoption, adoption, dependent children or orphans".

2.4 VAT.- VAT on share purchase costs is deductible

Court of Justice of the European Union. Judgment of October 17, 2018

As discussed in our VAT alert: Alerta IVA 2-2018, the CJEU has concluded that input VAT on the purchase of shares is deductible if the intention to provide services to the acquired subsidiary is substantiated. This includes input VAT on advisory services related to the purchase, even if it does not ultimately take place, so the services are never actually provided to the potential subsidiary.

2.5 Transfer and stamp tax.- Only one stamp tax charge when horizontal property established and condominium dissolved in one transaction

Catalonia High Court. Judgment of April 26, 2018

Stamp tax is charged under the notarized documents heading on the first copy of notarized public deeds and certificates that relate to an amount or valuable item and contain transactions or agreements that may be registered. Where two transactions are documented in the same deed, you might expect there to be two stamp tax charges.

Catalonia High Court has concluded, however, that where the establishment of the horizontal property system and the dissolution of the existing condominium are documented in the same deed, stamp tax is only chargeable on dissolution of the condominium, insofar as it is a necessary transaction for subsequent establishment of the horizontal property system.

2.6 Transfer and stamp tax.- Transfer of share in tenancy in common to another tenant in common is not an exempt excess allocation if tenancy in common is not dissolved

Catalonia High Court. Judgment of May 17, 2018

Certain specific excess allocations are exempt from transfer and stamp tax. It is settled case law, for example, that excesses resulting from the allocation to a tenant in common of an indivisible property are exempt.

In this judgment, however, it was concluded that this exemption only applies where the reason for that allocation to a tenant in common is the dissolution of the tenancy in common.

The case under examination concerned a tenancy in common with four members in which one transferred his share to the others, without the tenancy in common being dissolved. In this case, concluded the Catalonia High Court, the exemption does not apply.

2.7 Tax on large retail establishments.- Tax on large retail establishments is lawful

Supreme Court. Judgments of September 19 and September 26 2018

The Supreme Court has rendered various judgments on the lawfulness of the regulations related the taxes on large retail establishments in Catalonia and Navarre, autonomous community taxes charged on the economic capacity of superstores and retail establishments as a result of the adverse impacts they cause to the environment and the organization of land.

Specifically, it confirmed that the legislation is not unconstitutional or contrary to EU law, according to the CJEU's findings in its judgments rendered on April 26, 2018. In relation to Catalonia, however, it concluded that the fact of leaving collective establishments measuring more than 2,500 meters outside the tax is state aid, and for that reason it set aside Decree 324/2001 approving the Regulations on the tax on large establishments in the Catalonia region. The decision

as to the effects of this finding of state aid on assessments of the tax depends on the judgments on these assessments that are expected over the coming days.

2.8 Financial liability of the state.- Basque provincial governments not required to indemnify companies for refund of aid equal to 45% of investments

Supreme Court. Judgment of September 5, 2018

As we discussed in our October provincial tax newsletter for the Basque Country (Newsletter Fiscal Foral País Vasco – Octubre 2018), the Supreme Court has held that the legal requirements had not been satisfied for Basque provincial governments to have any obligation, arising from the financial liability of the state, to the beneficiary companies of aid in the form of an asset equal to 45% of the investments made, after they had to refund them under the European Commission Decision holding that they were contrary to EU law (Decision 2002/820, of July 11, 2001).

2.9 Audit procedure.- Orders for entry and search by Tax Agency officials must be sufficiently reasoned

La Rioja High Court. Judgment of June 7, 2018

La Rioja High Court recalled that the decision authorizing the entry and search of a property by tax auditors must be sufficiently reasoned. For the reasoning to be valid it must set out the necessary information to particularize the case and to support that the measure is reasoned and justified, for which reason general references to the existence of circumstances indicating infringements are not acceptable.

In other words, the decision must contain reasoning that paints a sufficiently broad picture of the circumstances indicating breaches of tax law by the parties with tax obligations, and must also assess the reasonableness and proportionality of the entry and search.

2.10 Audit procedure.- If a reassessment has effects on other non-audited years, tax authorities must correct returns

National Appellate Court. Judgment of May 16, 2018

The outcome of an audit often has effects on later years on which returns have been filed. The question associated with this is whether the taxable person must file supplementary or correcting returns for those later years and whether, moreover, in the first case, they must pay the related late filing surcharges.

The National Appellate Court was categorical in concluding that the tax authorities may not transfer to taxpayers the burden of correcting their self-assessments if the interpretation adopted by the tax authorities in their audit work has an effect on other years. In these cases, the tax authorities must, on their own initiative, make the reassessment for later years.

3. DECISIONS

3.1 Personal income tax.- Continuous residence test to claim exemption for reinvestment in principal residence must be met from when ownership obtained

Central Economic-Administrative Tribunal (TEAC). Decision of September 18, 2018

To claim the exemption for reinvestment in the principal residence for personal income tax purposes, the transferred property and the acquired property must qualify as the principal residence, for which one of the requirements is that the person must have lived there at least three years.

Specifically, that period in relation to the transferred residence may only be calculated from when that residence was acquired, without including any earlier periods of residence (under a lease or other arrangements).

3.2 VAT.- Rate applicable to repair work on residential properties caused by insured losses varies according to who is the customer

TEAC decision of September 25, 2018

The tax rate applicable to repair work on residential buildings, depends on who is the customer for the work. Where the customer for the work is the insurance company, the standard rate applies, whereas if the customer is the individual who uses the residence the reduced rate is chargeable.

In the TEAC's opinion, the customer for the work is the individual if the compensation method under the insurance policy is the payment of indemnification by the insurance company. For the insurance company to be the customer for the repair work, the repair or replacement of the damaged item must be substituted for that indemnification.

3.3 Transfer and stamp tax.- Stamp tax base in declarations of new construction is construction cost

Central Economic-Administrative Tribunal. Decisions of September 20 and July 13 2018

The stamp tax base related to deeds for declaration of new construction consists of the actual value of the cost of the new construction that is being declared. This decision raised the issue of what "actual value of the cost of the construction" means.

TEAC concluded that "actual value of the cost of the construction" means how much the construction work actually cost to complete, without having to increase the value of the property according to the value of the new construction placed on the market. Those items (construction cost as opposed to finished property value) are not necessarily the same, insofar as factors such as location or use may have an effect on the value of a property whereas they do not necessarily affect construction cost.

This same interpretation had already been adopted by the Supreme Court in judgments of April 9, 2012 and April 10, 2014.

3.4 Special taxes.- Forfeiture of right to exemption or to reduced rate in cases of procedural breaches is not automatic

Central Economic-Administrative Tribunal. Decision of September 25, 2018

TEAC adopted in this decision the Supreme Court's interpretation in its judgment of February 27, 2018 (Tax Newsletter / 22-05-2018) to the effect that a breach of procedural requirements in relation to special taxes does not give rise to automatic forfeiture of the right to an exemption or to a reduced rate, if the party with tax obligations shows that the factual requirements laid down to claim the tax benefit have been satisfied.

In other words, forfeiture of the tax benefit may only occur where the monitoring authorities conclude, from furnished proof, that the products were not used for the purposes that give entitlement to an exemption or to the reduced rate.

3.5 Management procedure.- TEAC adopts Supreme Court interpretation that assessment of property values cannot consist of increasing cadastral value by multiplier

Central Economic-Administrative Tribunal (TEAC). Decision of September 20, 2018

Following the interpretation determined by the Supreme Court in a judgment rendered on May 23, 2018 (Tax Newsletter - June 2018), TEAC concluded that the assessment method by reference to cadastral values increased by multipliers is not suitable for calculating property values for taxes in which the tax base is determined legally by reference to their actual value (such as inheritance and gift tax and transfer and stamp tax), unless the method is supplemented by carrying out a strictly auditing method directly related to the valued property.

However, after setting aside an assessment due to using that method based on cadastral values, it gave the authorities a second chance, by ordering reversion of the audit so they would be able to issue another assessment.

3.6 Information requests.- Information requests made to bar associations in relation to members' fees are lawful

Central Economic-Administrative Tribunal. Decision of September 18, 2018

The tax authorities requested from a bar association specific reports and opinions on their members' fees in respect of procedures for claiming legal fees and claims in and out of court, and on the determination of legal costs. As a result of not agreeing with the request for information (by considering it was general and indiscriminate and lacked tax relevance), the bar association followed the relevant appeal routes, ending with this decision by TEAC.

TEAC held that the request for information is lawful, because tax relevance may not be questioned, and needs no further explanation or reasoning, given that the sought aim is to facilitate the work of the tax auditors. It underlined in this respect that the members on which information is requested are potential taxpayers and are connected with the bar association by reason of their commercial or economic activity. Moreover, it was determined that the requested information is confined to a specific time period.

4. RULING REQUESTS

4.1 Corporate income tax.- Brexit is a valid economic reason for applying the tax neutrality regime

Directorate General for Taxes. Ruling V2253-18, of July 26, 2018

The requesting taxpayer intended to carry out a cross-border merger between a Spanish resident entity and another entity resident in the UK, in which the absorbing entity would be the Spanish resident entity. The primary aim of the merger is to provide the necessary flexibility to ensure that, after Brexit, the group will be able to provide services to its clients consistently throughout Europe, besides maintaining suitable conditions to ensure that employees can travel to other countries where necessary.

According to the DGT, these are valid reasons for applying the tax neutrality regime.

4.2 Corporate income tax.- Hotel business carried on through investee is not line of business

Directorate General for Taxes. Ruling V2058-18, of July 11, 2018

A company owning a hotel that it leases to a subsidiary for the subsidiary to manage with its own material and human resources wanted to spin off the hotel business. The DGT took the view that the tax neutrality regime cannot be claimed for the spin-off because the assets to be transferred do not amount to a line of business.

4.3 Corporate income tax.- Distribution of additional paid-in capital qualifies for exemption under article 21

Directorate General for Taxes. Ruling V2043-18, of July 11, 2018

A Netherlands resident entity, wholly owned by a Spanish company, made a distribution of additional paid-in capital in kind, by delivering to its shareholder a 100% ownership interest in another Spanish entity. The distribution was made at the market value of this latter entity. This transaction would need the Spanish shareholder to include in its tax base the positive difference between the market value of the received elements and their tax value at the company making the distribution.

This difference qualifies for the exemption under article 21 of the Corporate Income Tax Law because it may be treated as income from the transfer of shares.

4.4 Personal income tax.- Directors not eligible for certain personal income tax exemptions

Directorate General for Taxes. Ruling V1984-18

The DGT summarized the special provisions on personal income tax in relation to salary income obtained by directors with executive functions.

This matter is particularly relevant as a result of application of the "bond" theory (*teoría del vínculo*), under which the Supreme Court has been holding that a senior manager leaves behind their employment relationship when they become part of the managing body. That employment relationship, it is said, is included in the new commercial relationship. In the DGT's view, this means that all the compensation of the new director is deemed to result from the commercial relationship.

This implies that, while remaining within the scope of salary income for personal income tax purposes, certain special provisions apply:

(a) On the one hand, all types of compensation in kind are taxed, in other words, the cases of compensation that is not subject or is exempt envisaged for taxpayers with an employment relationship do not apply. Therefore, training courses, medical insurance contributions, meal or childcare vouchers, etc. are taxed. These types of compensation are taxed on their cost or market value as applicable.

(b) Per diems for normal meal and overnight expenses are also taxed, unless they are expenses assumed on behalf of a third party and this can be proved.

(c) The exemption may not be claimed for work performed in other countries.

(d) The withholding tax rate will be the fixed 35% rate (or 19%, according to the entity's net revenues).

Lastly, it is clarified that any types of compensation for performing director functions do not fall within the scope of controlled transactions.

4.5 Personal income tax, VAT and wealth tax.- Clarification of treatment for various taxes of the lease of property with additional services

Directorate General for Taxes. Ruling V2297-18, of August 7, 2018

The owner of a chalet intends to rent it through a company engaged in tourism services. Two options are proposed: (1) renting the property to the tourism services company for it to rent out the property and provide additional services on its own behalf, or (2) the owner renting out the property directly to the tenant, but hiring the additional services from the tourism services company.

The DGT examined the tax implications for three taxes:

(a) VAT: In both scenarios the lease is subject and not exempt by being accompanied by additional services related to the hotel industry. The tax rate varies according to which arrangement is implemented. If the property is rented to the services company, 21% VAT must be charged by the owner (regardless of the rate that must be charged by the company to the tenant). If the property is rented directly to the tenant, the applicable rate is 10%.

(b) Personal income tax: The rental of the property to the services company gives rise to income from movable capital. Conversely, the income obtained from renting directly to the tenant together with the services mentioned (even if through the services company) qualifies as income from economic activities.

(c) Wealth tax: In neither case does the family business exemption apply in that, for the purposes of this tax, no economic activity is performed .

4.6 Personal income tax.- Penalty for breaching minimum holding period for pension plan gives rise to loss from movable capital

Directorate General for Taxes. Ruling V2167-18, of July 20, 2018

An individual receives a reduction from a banking institution for transferring a pension plan to that institution, subject to the condition that the pension plan must be held for five years.

The DGT confirmed that if that holding period is not met, the penalty that the financial institution applies will give rise to a loss from movable capital.

4.7 Nonresident income tax.- Severance payments for termination of employment contracts of nonresidents are taxed in Spain for period worked there

Directorate General for Taxes. Ruling V2188-18, of July 23, 2018

An entity has sent employees abroad, which makes them nonresidents. A number of workforce adjustments are going to be made through unjustified dismissals, objective dismissals and terminations by mutual accord.

Based on the contents of the commentaries on the OECD Model Convention, the DGT concluded that the severance payments made in any of the three types of termination will be deemed to derive from an employment relationship, and therefore the tax treaty article on income from employment (article 15, generally) will apply.

In general, it may be inferred from that article that only severance payments derived from work performed in Spain are taxable in Spain, in which case the exemption under the Personal Income Law for severance payments in respect of dismissal may apply (unless the termination is by mutual accord). To determine the portion of the severance payment that is deemed to be obtained in Spain, in general the amount must be distributed proportionally among the countries where the employment relationship was performed, by reference to the time worked in each country.

If other types of indemnification are received to remedy any type of loss (punitive damages, indemnification for discriminatory treatment, indemnification for damage to reputation), this type of income is taxable, in principle, only in the employee's state of residence (article 21 of the Model Convention).

Under a specific rule, applying to terminations by mutual accord, if the severance is paid in monthly installments rather than as a lump sum and the former employee regains tax residence in Spain in the period in which the severance is paid, it will become taxable in Spain (under the principle of taxation on worldwide income).

4.8 Tax on economic activities.- An unincorporated joint venture (UTE) carries on an economic activity separate and independent from that of its members

Directorate General for Taxes. Ruling V2033-18, of July 9, 2018

The DGT concluded that an unincorporated joint venture is treated as a separate taxable person for the purposes of the tax on economic activity with respect to the individuals or entities investing in it, and, as a result, it carries on an economic activity that is separate and independent from that of its members.

Applying this interpretation, the DGT explained, among other questions, that, for the purposes of the exemption from the tax on economic activities, regard must be had to whether or not the net sales/revenues from all the activities carried on by the unincorporated joint venture itself in the year are below 1 million euros.

5. LEGISLATION OF INTEREST

5.1 Tax amendments to reduce wholesale electricity prices

To reduce the price of electricity on the wholesale market, Royal Decree-Law 15/2018, of October 5, 2018 (Official State Gazette -BOE-, October 6), on urgent measures for energy transition and consumer protection has introduced the following new legislation:

(a) Electricity generated and fed into the electricity grid in the last quarter of 2018 and the first quarter of 2019 is exempt from the tax on the value of electricity output.

(b) An exemption from hydrocarbons excise tax is provided for energy products used in electricity generation at electric power plants or in electricity generation or in the cogeneration of electricity and useful heat in combined cycle plants. To claim this exemption, an application must first have been made to the office managing the tax by the owner of the electric power plants or the combined cycle plants and the exemption must have been authorized by that office.

5.2 Publication of list of municipalities applying revised cadaster value multipliers approved for 2019

On September 29, 2018, the Official State Gazette (BOE) published Order HAC/994/2018, of September 17, 2018, setting out the list of municipalities to which the revised cadaster value multipliers set out in the General State Budget Law for 2019 apply.

5.3 Annual equivalent rate approved for fourth calendar quarter of 2018, for the purpose of characterizing certain financial assets for tax purposes

On September 27, 2018 the Official State Gazette (BOE) published the decision of September 26, 2018, 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 fourth calendar quarter of 2018. The rates are as follows:

- Financial assets with terms of four years or less: -0.049 percent.
- Assets with terms between four and seven years: 0.328 percent.
- Assets with ten-year terms: 1.194 percent.

- Assets with fifteen-year terms: 1.438 percent.
- Assets with thirty-year terms: 2.066 percent.

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

6. NEWS

6.1 Council of the European Union authorizes Spain to reduce exercise tax on electricity for vessels at berth in a port

Law 6/2018, of July 3, 2018, on the General State Budget for 2018, introduced an economic incentive for the use of electricity from the electricity grid on land to reduce atmospheric pollution at port cities. The use of that electricity for vessels at berth in ports to satisfy their electricity needs is considered to be better for the environment than the burning of bunker fuels by those vessels.

This measure was authorized by the Council of the European Union in its Implementing Decision 2018/1491 adopted on October 2, 2018.

6.2 Decision to allow future reduction to VAT rate applicable to electronic publications

On October 2, 2018, the Economic and Financial Affairs Council of the European Union reached an agreement on a proposal for a Directive allowing member states to apply reduced, super-reduced, or zero, VAT to electronic publications, allowing the alignment of VAT rules for electronic publications and physical publications.

6.3 Publication of draft royal decree amending Spanish Chart of Accounts

The draft royal decree amending (i) the Chart of Accounts approved by Royal Decree 1514/2007, of November 16, 20017; (ii) the Chart of Accounts for Small and Medium Sized Enterprises approved by Royal Decree 1515/2007, of November 16, 2007; (iii) the Rules on the Preparation of Consolidated Financial Statements approved by Royal Decree 1159/2010, of September 17, 2010; and (iv) the Rules Adapting the Chart of Accounts to not-for-profit entities approved by Royal Decree 1491/2011, of October 24, 2011 was made public on October 4, 2018.

This draft legislation contains the proposed adaptation of Spanish accounting legislation to two important international accounting projects concerning the treatment of financial instruments and the recognition of revenue from contracts with customers.

The reform is set to come into force on January 1, 2020.

6.4 Publication of first report on conflict in application of the law, regarding leveraged purchases

In the past, "fraud upon the law", now "conflict in application of the law" (with the addition of its own characteristics) was not punishable. In the latest reform of the General Taxation Law, however, a new tax infringement was created, linked to this definition. So now, it is an infringement to breach tax obligations (failure to pay over tax or incorrectly applying for refunds and tax incentives or, lastly, unlawfully claiming tax assets) as a result of acts or transactions meeting the requirements for "conflict in application of the law", or in other words, if they are artificial and no significant effects other than saving tax are achieved from using them.

For that infringement to exist, however, the act or transaction must be substantially the same as other acts or transactions on which an administrative interpretation had been established and published for public knowledge before the acts or transactions at issue were performed.

Under this legislation, the first report on "Conflict no 1" was published in October 2018. Corporate income tax. "Intragroup finance costs" (dated April 10, 2018). The report concludes that there is conflict in application of the law in relation to a purchase, by a Spanish company, of shares in companies in the same group with intragroup financing, after concluding that the reorganization has not had any relevant legal or economic effects other than an increase in deductible expenses (interest) arising from the intragroup financing.

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