**Briefing note** April 2012

# Tax measures introduced by Royal Decree-law 12/2012, of 30 March

On Saturday 31 March 2012, the Official State Gazette published Royal Decree-law 12/2012, dated 30 March, which introduces several tax and administrative measures designed to reduce the public deficit ("RDL 12/2012").

Given the significance of the tax measures announced, this memo aims to provide a brief outline of the main characteristics and implications of the modifications introduced.

Among the measures adopted, some are of an indefinite nature (nos. 1 to 3), other are temporary and only apply to 2012 and 2013 (4 to 6) and others are of an exceptional nature (7 and 8).

By way of an initial comment, it should be highlighted that these measures are already in force and apply to the 2012 financial year (even in the case of operations that commenced in past financial years, with the exceptions outlined below), except for those Corporation Income taxpayers whose financial year is different to the calendar year and has not yet commenced.

The main aspects and implications of the new tax measures introduced would be as follows:

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## 1 Limitation of the deductibility of financial expenses

In the sphere of the deductibility of the financial expenses generated in corporate groups, two different kinds of limitations are introduced: (i) the non-deductibility of financial expenses between companies of the same group for the acquisition or execution of capital contributions; and (ii) a limitation on the deductibility of debt within the scope of groups.

### 1.1 *Non-deductibility of financial expenses between companies of the same group for the acquisition or execution of capital contributions*

First of all, RDL 12/2012 introduces a new category of non-deductible financial expenses in the context of financing operations between companies of the same group. Generally speaking, the following financial expenses derived from debts with group entities will not be tax deductible when for the purposes of (i) the acquisition, from other group entities, of stakes in the capital or own funds in any kind of entity, or (ii) making capital injections or contributing own funds to any other group entities.

However, these expenses will be deductible where the taxpayer can prove the existence of **valid economic reasons** for said operations.

### *1.2 Limitation on the deductibility of debt within the scope of groups*

Moreover, applicable to tax periods starting as of 1 January 2012, net financial expenses[1] will be tax deductible with a limit of 30% of the operating profit for the financial year[2].

Generally speaking, this limitation on the deductibility of Net Financial Expenses will only apply within a corporate group, as <u>this measure does not apply</u> to those entities that **do not form part of a group** according to the criteria established in Article 42 of the Commercial Code[3].

It is worth specifying that, even if a group cannot be said to exist, the limitation on the Operating Profit will apply when the financial expenses derived from debts with persons or entities holding a direct or indirect stake of at least 20 per cent in the entity or the financial expenses derived from debts with entities in which a direct or indirect state of at least 20 per cent is held, exceed 10 percent of the net financial expenses.

Likewise, this limitation will not apply to **credit institutions**[4] under any circumstances.

The following are some of the most noteworthy characteristics of this measure:

- In any event, the Net Financial Expenses for the tax period will be deductible up to 1 million euros.
- Those Net Financial Expenses not deducted may be deducted in the tax periods ending in the following 18 years.
- In the event the Net Financial Expenses of the tax period fail to reach the limit of 30% of the Operating Profit, the difference between said limit and the Net Financial Expenses for the tax period may be accumulated (being added to the 30% limit) in the tax periods ending the following 5 years.
- In the case of joint ventures (*agrupaciones de interés económico* or "**AIE**") the Net Financial Expenses will be attributed to the members of the AIE insofar as they exceed the deductible limit and will, in turn, be

[1] In this regard, *net financial expenses* will be understood as the excess of financial expenses with regard to the income from interest accrued in the tax period, excluding the non-deductible financial expenses referred to in point 1.1. above ("**Net Financial Expenses**").

[2] In this regard, *operating profit* will be understood as the figure obtained from the operating results in the profit and loss account for the financial year determined in accordance with the Commercial Code and the other accounting rules that implement it, minus depreciation of property, grants for non-financial assets and others, impairment and results from the transfer of fixed assets, plus income from equity interests, provided that they correspond to dividends or stakes in the profits of entities in which, either the direct or indirect percentage stake is at least 5 per cent, or the acquisition price of the stake does not exceed 6 million euros, unless said stakes were acquired with debts whose financial expenses are non-deductible by virtue of letter h) of section 1 of Article 14 of this Law ("**Operating Profit**").

[3] In general terms, according to Article 42 of the Commercial Code, a group exists when one company holds, or may hold, direct or indirect control over another or others.

[4] However, in the case of credit institutions that pay tax under the tax consolidation system in conjunction with other entities that do not hold the same status, the limit established in this article will be calculated for the latter taking into account the Operating Profit and the Net Financial Expenses of said other entities.

taken into the account for the limit of the individual members themselves. The financial expenses attributed to the members because they exceed the legal limit will not be deductible for the AIE.

– In the case of entities that pay tax under the tax consolidation system, the 30% limit envisaged will refer to the tax group, with the financial expenses pending deduction receiving the same tax treatment as that which corresponds to tax loss carryforwards in the case of cancellation or exclusion of the tax group.

The above limitations will apply to all debts within the scope of groups, including those incurred or contracted prior to the entry into force of RDL 12/2012.

The deductibility system for financial expenses set out herein replaces the thin-capitalisation rules established in former Article 20 of the Corporate Income Tax Law, approved by Legislative Royal Decree 4/2004, ("**CIT Law**"), derogated as of 1 January 2012, for financial years starting after that date.

As a **final conclusion**, given the potential impact that this measure may have, it is essential to review the financing structures within corporate groups, with a view to determining whether the limits established for the deductibility of financial expenses actually apply to each particular case (in particular, heavily leveraged corporate structures).

## 2 Abolition of the free depreciation incentive for large companies

Effective as of 31 March 2011, the special free depreciation regime regulated in the Eleventh Addition Provision of the CIT Law is derogated.

In this regard, it is worth highlighting that those investments made **prior to 31 March 2012** and that fall under regimes that predate the entry into force of RDL 12/2012, may apply this incentive in the same conditions established in the regime applicable to them, meaning that the rule is not retroactive.

However, a quantitative limitation is introduced with regard to the application of the regime for the tax periods starting in 2012 and 2013. Said limitation varies depending on whether[5] or not[6] the employment maintenance requirement is applicable to the investment made. In the event that the employment maintenance requirement applies, the limit for application of the regime will be 40% of the tax base, otherwise it is reduced to 20% of the tax base.

Moreover, these limits will also apply in relation to current investments made until 31 March 2012, which correspond to new elements ordered by virtue of agreements for the execution of works or investment projects whose period of execution, in both cases, requires a term in excess of two years from the date of the order or start of the investment and the date it is made available or start-up date.

Finally, it is worth highlighting that the previous freedom of depreciation regime will continue to apply to "small entities", provided it is linked to the creation of employment.

As a **final conclusion**, in view of the regulatory changes and the different regime applicable to the freedom of depreciation by virtue of RDL 12/2012, we recommend a case-by-case examination of each asset element that took advantage of this tax benefit in order to determine effective compliance with the applicable requirements with a view to being able to apply this regime.

## 3 Partial exemption regarding the transfer of stakes held by non-resident entities

Article 21.2 CIT Law has been amended in order to introduce certain criteria rendering the partial application of tax exemptions more flexible in those cases where income is derived from the transfer of stakes held by a non-resident entity.

In general terms, in order for such exemption to apply, the requirements established in Article 21.1 must be met relating to a) being a stake-holder, b) having paid tax similar to Corporation Income Tax, and c) the origin of the

[5] Investment made in general terms during the 2009 and 2010 financial years, to which the freedom of depreciation regime is applicable according to the wording of Royal Decree-law 6/2010, of 9 April.

[6] Investment made in general terms during the 2011 financial year and up to 31 March 2012, to which the freedom of depreciation regime is applicable according to the wording of Royal Decree-law 13/2010, of 3 December.

corporate profit. Accordingly, the requirement consisting of being a stake-holder must be met on the day transfer takes place, and requirements established in sections b) and c) must be met **in each any every one of the fiscal years in which the stakes are held.**

The main modification introduced by RDL 12/2012 is the possibility to partially apply the exemption in those cases in which the requirements established in sections b) and c) were not met in one or more of the fiscal years in which the stake is held, based on a criterion of proportionality according to the period in which such requirements were met:

- in the case of income corresponding to non-distributed profits, the percentage corresponding to profits generated in fiscal years in which the requirements established in both sections b) and c) were met will be considered exempt[7].
- in the case of income that does not correspond to non-distributed profits (tacit capital gains), it will be understood that the income was generated, unless proof to the contrary is provided, in a linear manner, whereby the percentage that proportionally corresponds to the fiscal years in which the requirements established in both sections b) and c) were met will be considered exempt.

In short, even in cases where the requirements established for the application of the exemption were not met in each and every one of the fiscal years in which the stakes are held, the new regulation allows the exemption to be applied partially on the percentage of the income corresponding to those years in which the said requirements were effectively met, with respect to the total period during which the stakes were held.

As regards the percentage of the income to which the exemption does not apply, generally deductions can be made on the same according to the international double taxation provisions under Article 31 CIT Law.

**Finally**, **to summarise,** this modification entails greater flexibility with respect to the requirements in place for the application of this exemption, triggering the possibility to receive this type of income in Spain subject to lower taxation.

## 4 Limitation on the deductibility of goodwill

This measure aims at establishing the same limitation applied since 2011 on financial goodwill and extend the same to other kinds of goodwill for tax purposes.

In this way, and enforceable for the tax periods commencing in the years 2012 and 2013, the maximum annual limit deductible from the intangible assets corresponding to the goodwill is reduced from 5% to 1%, in the case of both the acquisition of entities (Article 12.6 CIT Law) as well as corporate restructurings (Article 89.3 CIT Law). In other words the 8% deduction applicable to such goodwill is extended for two additional years (years 21 -5%- and 22 -3%- as from commencement thereof).

**To summarise**, this goodwill deferral measure may have a relevant impact on the taxable base of Corporation Tax for the 2012 and 2013 financial years.

## 5 Limitation on the application of Corporation Income Tax deductions

Enforceable for the tax periods commencing in the years 2012 and 2013, the following modifications have been introduced in relation to the limits on the application of deductions regulated in Article 44 CIT Law:

- on a general basis, the limit on the gross tax quota is reduced from 35% to 25%[8].
- In the case of the deduction for I+D+i and the deduction for the development of Information Technology, the 60% limit is reduced to 50% (if investments exceed 10% of the gross tax quota[9]).

[7] Except for those cases in which the non-resident entity holds, directly or indirectly, stakes in entities resident in Spanish territory or assets located in such territory and the total market value of such stakes or assets exceeds 15 percent of the market value of its total assets, and where the exemption only applies to the non-distributed profits regarding stakes held in financial years in which the requirements established in sections b) and c) are met.

[8] Reduced in the deductions to avoid the Spanish and international double taxation and rebates.

[9] See previous note.

- The new limits introduced will be applied on an exceptional basis to the **deduction for reinvestment of extraordinary profits,** where the current deduction is taken into account to calculate such limit.

Notwithstanding the above, the negative impact of this limitation is offset by the extension of the periods for the application in future tax periods of pending deductions which on a general basis increase from 10 to 15 years (from 15 to 18 years in the case of I+D+i and development of IT deductions) applying to the deductions that were pending application at the start of the first tax period commencing as from 1 January 2012.

## 6 Minimum Corporate Income Tax payments on account for large companies

The obligation to pay minimum Corporate Income Tax payments on account will take effect in those tax periods beginning during 2012 and 2013. Its characteristics are as follows:

- it will apply to those taxpayers whose net turnover during the twelve months prior to the date on which the tax periods begin is at least 20 million euros.
- the rate applied will be 8% of the tax payments on account base (or 4%, if at least 85% of the company's income corresponds to income that is tax-exempt or dividends entitled to double taxation deductions).
- the tax payments on account base will be calculated on the accounting income[10] and not on the taxable base used to calculate Corporation Income Tax.
- on the next Corporate Income Tax payment on account to be made prior to 20 April 2012, the tax rate of 4% will be applied to the base[11] .

## 7 Specific tax on dividends and income from foreign sources deriving from the transfer of securities representing the own funds of entities not resident in Spain

Exclusively for the 2012 financial year, a specific tax of 8% will be applied to income from foreign sources[12] , so as to permit the repatriation of dividends or the transfer of stakes (thus not forming part of the taxable base for Corporation Tax purposes[13]), corresponding to entities located in tax-free territories or in tax havens, with said circumstance preventing the application of the exemption regime.

Both the dividends and the income deriving from the transfer of securities in non-resident entities must fulfil the requirements of Article 21.1 a) and c) CIT Law (regarding stakes in and profit from the execution of business activities abroad).

The specific tax must be self-assessed and be paid within the 25 calendar days after the accrual date[14], according to an *ad hoc* model to be approved by ministerial order.

[10] The calculation base used will be the positive result from the profit and loss account for the financial year of the first three, nine or eleven months of each calendar year, minus tax losses to be offset by taxpayers, taking into account the new limits governed by Article 9, First section, Point two of Royal Decree-law 9/2011, dated 19 August, on measures to improve the quality and coherence of the national health system, to contribute to tax consolidation, and to raise the maximum amount of State guarantees for 2011.

[11] Or 2%, if at least 85% of the company's income corresponds to income that is tax-exempt or dividends entitled to double taxation deductions.

[12] Dividends or stakes in profits, as well as the income derived from the transfer of securities in non-resident entities, subject to this special tax, will not generate a right to the application of the international double taxation deduction. Furthermore, the accounting cost will not be tax-deductible for Corporation Income Tax purposes.

[13] However, in the case of the transfer of securities representing the equity of entities not resident in Spain, the part of the taxable base which corresponds to any value correction that may have been considered tax deductible during the time the stake was held, will be taxed at the corresponding Corporate Income Tax rate for the taxpayer.

[14] The date on which the resolution to pay a dividend is passed or the securities are transferred.

## 8 Filing of the "Special Tax Return" prior to 30 November 2012 ("Voluntary Tax Regularisation")

A "Special Tax Return" may be filed, whereby taxpayers of Personal Income Tax, Corporation Income Tax or Non-Resident Income Tax who hold assets or rights not declared under said taxes, may voluntarily regularise their tax situation.

This excludes those taxes and periods for which returns would have been filed and payments made after the Tax Authorities had issued notification of the start of the verification or investigation procedure which would determine the tax debts corresponding to the same.

Those taxpayers who so wish, must file a tax return and deposit the resulting amount, after applying a tax rate of 10% to the price or acquisition value of the goods or rights.

Given the extraordinary nature of the measure, it establishes that neither sanctions, nor interest, nor surcharges will be enforceable.

In order for taxpayers to take advantage of this regime, the Ministry of Finance and Public Administration will approve a specific form to be used for these returns, with the deadline for filing them and depositing amounts being 30 November 2012.

Lastly, a general amendment is made to General Tax Law 58/2003, exonerating those taxpayers who have regularised their situation from criminal liability. This measure is not limited only to those cases indicated in the Voluntary Tax Regularisation.

## 9 Other tax measures

The RDL also introduces other measures of various types, which we will briefly mention below:

- **Modification of Personal Income Tax** to apply the modifications made to Corporation Tax in relation to the freedom of depreciation, in conjunction with the determination of the tax rate on income obtained in the subsequent transfer of the asset that was the subject of said accelerated depreciation.

- **Modification of the Tax on the Increase in Price of Urban Land,** with the application of a reduction of the taxable base now becoming optional for city councils when the cadastral values are modified as a result of a general and collective appraisal procedure. This measure enables city councils to increase their financial autonomy and thus reduce the deficit of the municipal corporations.

- **Modifications to the Tax on Tobacco Production,** in which a modification has been made in the scope of the definitions in line with European Union and the tax rate has been revised.

We hope that the preceding information is useful to you. We are at your disposal to clarify or expand on any of these matters, as you see necessary.


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