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Tax Alert

Tax Department

Tax reforms envisioned in the draft of the State Budget Bill for 2019

On 14 January, the government laid its draft of the State Budget Bill for 2019 before the Spanish Congress of Deputies. The Bill envisages a number of tax changes we believe to be highly relevant. Below we will provide a general outline of the main reforms yet to make its way through Congress.

I. Corporate Income Tax ("CIT")

Turning our attention first to CIT, the draft of the State Budget Bill (hereinafter, the "**2019 SBB**") will usher in the following changes, which will apply to tax periods starting on or after 1 January 2019, provided they did not end prior to the entry into force of the 2019 SBB:

- **Minimum net tax liability (general rate):** one of the main changes relating to CIT is a new limit on the deductions and allowances that can be applied to the total tax due before deductions (known as the *cuota íntegra*). This means that taxpayers with net turnover of 20 million euros or more or those who pay CIT under the Consolidated Tax Regime will only be able to apply deductions on an amount of up to 10% or 8% of their tax base (when the applicable tax rate is 25% or 23%, respectively).

Following the introduction of this limit, the tax payable after applying those deductions and credits cannot be less than 15% of the positive tax base.

If it so happens that the deductions and/or allowances can no longer be applied after applying the limit, then the pending amounts can be carried over to following tax periods in accordance with applicable rules governing each such deduction or credit.

Taxpayers whose tax base for the year is negative or zero will not be affected by this new rule.

- **Minimum net tax liability in special cases:**
 - For credit institutions, which pay tax at 30%, the limit on deductions and allowances will now become 12% (minimum tax liability of 18%).
 - Newly formed companies that pay tax at 15% will not be able to apply deductions or credits on more than 5% of the amount of the total tax due before deductions (minimum tax liability of 10%).
 - Meanwhile, cooperatives will not be able to reduce their tax liability before deductions by more than 40% of that amount.

- Companies that pay tax at 4% because they operate in the Canary Islands Special Zone (known as ZEC) will not be subject to these new limitations.
- The following companies and entities also fall outside the scope of the new rule on minimum tax liability:
 - Entities that are subject to the tax regime established in Law 49 of 23 December 2002, governing the tax regime for non-profit entities and tax incentives for entities receiving private aid, and that tax pay at 10%.
 - The following entities set out in Law 35 of 4 November 2003, on collective investment schemes, when they pay tax at 1%:
 - Open-ended investment companies (“SICAVs”).
 - Financial investment funds.
 - Real estate investment trusts (REITs).
 - Real estate investment funds.
 - Mortgage market regulation funds (known as *fondos de regulación del mercado hipotecario*), as set out in Article 25 of Law 2 of 25 March 1981, regulating the mortgage market, which pay CIT at 1%.
 - The pensions funds governed by the revised text of the Law on Pension Plans and Funds, as enacted by Royal Legislative Decree 1 of 29 November 2002, and which pay CIT at 0%.
- **Limit of 95% on profits from dividends and capital gains on equity interests**

Correction for double taxation of dividends and capital gains

As we all know, Articles 21 and 22 of the Law in its current state provide tax exemption (subject to certain requirements) for 100% of dividends and profits obtained through permanent establishments (“PEs”) and capital gains on the transfer of equity interests in Spanish and foreign subsidiaries. The 2019 SBB lowers this exemption to 95% of the dividends, profits or capital gains obtained by the taxpayer. The 5% of the income that is no longer exempt—and therefore taxable—is to offset the possible management costs incurred by the taxpayer and which will likely have tax deductible profit.

Meanwhile, the new Bill modifies Articles 31 and 32 relating to the deduction for international double taxation on taxes incurred abroad on dividends and profit sharing arrangements. Following roughly the same lines as the tax exemption method, the deduction is now limited to the lowest of the following two amounts: the amount paid abroad or 95% of the tax that would be payable in Spain.

Economic Interest Groupings (“EIGs”)

On the subject of EIGs, the Bill ushers in the same amendments to bring their tax transparency system in line with the 95% deduction just discussed. Accordingly, the tax exemption on dividends paid out by the EIG is now limited to 95% of that pay-out. Similarly, and when determining the so-called cost of ownership of the owners the acquisition cost will be raised to 95% of the profits allocated but not effectively distributed to the owners.

Under the Tax Consolidation Regime, the Bill establishes that dividends or capital gains obtained from subsidiaries that are subject to the exemption provided for in Article 21 of the CIT Law will not be eliminated for tax purposes.

In cases where the exemption contained in Article 21 does not apply, the 2019 SBB fails to clarify whether the affected income should be eliminated.

Under the Special Regime for Mergers, the Bill states that in relation to income obtained from vertical mergers (wherein the absorbing company owns at least 5% of the absorbed company), the tax exemption at the absorbing company will be limited to 95% of the income obtained.

In vertical mergers that can benefit from the amortisation of the merger goodwill (Transitional Provision 27 of the CIT Act) because the stake was acquired before 2015, the amount of the goodwill amortised to yield a tax benefit and generated after the entry into force of the 2019 SBB will be lowered to 95% of the positive difference on the merger.

Under the **International Tax Transparency Regime**, whereby certain profit obtained through non-resident subsidiaries must be allocated (transparency) to the resident shareholders, the Bill states that the subsequent distribution of profit that was already taxed on allocation will not be taxed at 95% of the amount in question. Meanwhile, if the stake in the “transparent” company is transferred, the tax cost of the acquisition will be determined on the basis of 95% of the profits allocated but not effectively distributed.

Deduction for Domestic Double Taxation (Transitional Provision 23), whereby the double taxation amount deductible because it was included in the tax base for CIT at any of the companies transferring the stake is lowered to 95% of the amount currently in effect under existing CIT Law.

Transparency regime previously in effect. When determining the tax cost of owning stakes in “transparent companies” under the terms of Law 43 of 27 December 1995, the calculation will now include, aside from the amount paid for the stake, 95% of the profits that were not effectively distributed but on which tax was paid because they became transparent for tax purposes at the CIT-paying owner.

- **Tax rate of 23%** for entities with net turnover of below 1 million euros. This calculation should include the net turnover of both the Group and the companies controlled by a group of persons linked by family ties.

The reduced rate of 23% does not apply to undertakings that qualify as holding companies, or *entidades patrimoniales* (Article 5.2 of the CIT Law).

To correct the impact of the reduction in the tax rate, the deductions there to compensate for the limitations on amortisation in the 2013 and 2014 tax periods have been raised from 2% to 7% for taxpayers who now pay tax at 23%.

Similarly, taxpayers who chose to restate their balance sheet under the terms of Law 16/2012, and who are taxed at 23%, will see an increase in the deduction from the 2% currently in effect to 7%.

- **Rates for split payments:** the 2019 SBB also modifies the rates on split payments. For companies with turnover of over six million but less than 10 million euros, it climbs from five sevenths (5/7, i.e. around 71.5%) of the tax rate (rounded **down**) to nineteen twentieths (19/20, i.e. 95%) of the tax rate, rounded **up**. The Bill also amends the amount of the minimum split payment.

Accordingly, the applicable rates will be:

EXISTING LAW

Tax rate	% over rate	25%	30%	Tax base for applying the split payment rate
		General	Credit institutions and hydrocarbons sector	
Below 6 MM	N/A	18%	18%	On total tax liability less withholdings and split payments
Between 6 MM y 10 MM	5/7 rounded down	17%	21%	On tax base for the period
More than 10 MM	19/20 rounded up	24%	29%	On tax base for the period
Minimum split payment		23%	25%	Accounting profit minus previous split payments

LAW UNDER THE 2019 SBB

Tax rate	% over rate	25%	30%	Tax base for applying the split payment rate
		General	Credit institutions and hydrocarbons sector	
Below 6 MM	N/A	18%	18%	On total tax liability less withholdings and split payments
Between 6 MM y 10 MM	19/20 rounded up	24%	29%	On tax base for the period
More than 10 MM	19/20 rounded up	24%	29%	On tax base for the period
Minimum split payment (+10 MM)		24%	29%	Accounting profit minus previous split payments

- **Collective Investment Schemes:** the 2019 SBB will allow the tax office to check that SICAVs meet the requirements relating to the minimum number of shareholders. The tax office will report any breaches it detects to the Spanish Securities Market Commission (CNMV), which will then be required to inform the Tax Inspectorate of any revocations or suspensions it decides to impose in exercise of its authority.

II. Value Added Tax (“VAT”)

The 2019 SBB ushers in various changes in relation to **VAT rates**, including a lower rate of 10% for veterinary services and now including, among the books, newspapers and magazines taxed at 4%, those published and disseminated electronically, provided their content is not completely or predominantly video or audible music. The Bill also changes the rate of VAT payable on certain articles of feminine hygiene, which falls from 10% to 4%.

Turning to **formal obligations**, the Bill changes the deadline for filing the tax return (both individual and consolidated in the case of VAT groups) for November, which, as an exception, should now be submitted by no later than the 20th of December rather than the 30th.

III. Personal Income Tax (“PIT”)

Various changes to the PIT regime will take effect on the day immediately following the 2019 SBB’s publication and enactment as law in the Official State Gazette.

- **Two additional tranches have been added to the general scale for PIT (State-level tax)** These tranches are there to cover situations in which the general tax base exceeds 130,000 euros or 300,000 euros. The rates for each of these tranches are 24.50% and 26.50%, respectively, as shown below.

General tax base – Up to (euros)	Remaining tax base – Up to (euros)	CURRENT rate on sliding scale for State-level tax – Rate	NEW rate on sliding scale for State-level tax – Rate
0	12,450.00	9.5	9.5
12,450.00	7,750.00	12	12
20,200.00	15,000.00	15	15
35,200.00	24,800.00	18.5	18.5
60,000.00	70,000.00	22.5	22.5
130,000.00	170,000.00	22.5	24.5
300,000.00	Onwards	22.5	26.5

Accordingly, the marginal rates on the general scale based on the current tax rates charged by the autonomous regions of Spain would be as follows:

Autonomous region	NEW general rate	Current general rate
Andalusia	52.0%	48.0%
Asturias	52.0%	48.0%
Valencian Community	52.0%	48.0%
Cantabria	52.0%	48.0%
Catalonia	52.0%	48.0%
La Rioja	52.0%	48.0%
Aragón	51.5%	47.5%
Balearic Islands	51.5%	47.5%
Extremadura	51.5%	47.5%
Canary Islands	50.5%	46.5%
Murcia	50.0%	46.0%
Castilla-La Mancha	49.0%	45.0%
Galicia	49.0%	45.0%
Ceuta and Melilla	49.0%	45.0%
Castilla y León	48.0%	44.0%
Madrid	47.5%	43.5%

- The Bill increases the tax rate on any taxable savings base that exceeds 140,000 euros by including a new tranche and setting a tax rate of 27% on the excess.

Savings tax base – Up to (euros)	Remaining tax base – Up to (euros)	CURRENT rate – Rate	NEW rate – Rate
0	6,000.00	19	19
6,000.00	44,000.00	21	21
50,000.00	90,000.00	23	23
140,000.00	Onwards	23	27

- The Bill also adds two further tranches to the scale of withholdings and payments on account for taxpayers who receive earned income. These tranches are there to cover situations in which the withholding tax base exceeds 130,000 euros or 300,000 euros. The rates to apply to each of these tranches are 47% and 49%, respectively, as shown below.

Tax base for earned income withholdings – Up to (euros)	Remaining tax base for withholdings – Up to (euros)	CURRENT rate – Rate	NEW rate – Rate
0	12,450.00	19	19
12,450.00	7,750.00	24	24
20,200.00	15,000.00	30	30
35,200.00	24,800.00	37	37
60,000.00	70,000.00	45	45
130,000.00	170,000.00	45	47
300,000.00	Onwards	45	49

- In relation to **workers relocated to Spanish territory**:
 - i) **The tax rate is increased** on income **exceeding 600,000 euros** received by workers relocated to Spain, who will now be taxed at **49%**:

Tax base – Up to (euros)	CURRENT rate – Rate	NEW rate – Rate
Till 600,000 euros	24	24
From 600,000 euros	45	49

- ii) In line with the increase in the tax rate on the savings tax base, the **tax rate** for this type of income received by “impatriates” has been raised where the amount of that tax base exceeds 140,000 euros, as follows:

Savings tax base – Up to (euros)	Remaining tax base – Up to (euros)	CURRENT rate – Rate	NEW rate – Rate
0	6,000.00	19	19
6,000.00	44,000.00	21	21
50,000.00	90,000.00	23	23
140,000.00	Onwards	23	27

- iii) The **withholding rate** on earned income that **exceeds 600,000 euros** has been raised to **49%** (previously 45%).

IV. Wealth Tax ("WT")

The 2019 SBB increases the rate applicable under the last tranche of the tax scale for WT. The rate for taxable wealth that exceeds 10,695,996.06 euros is set to climb from 2.5% to 3.5%.

Meanwhile, the Bill definitively repeals, effective from 2020 onward, the general discount or allowance of 100% of the full WT tax liability, which in December 2018 the government decided it would once again disapply in 2019.

V. Non-Resident Income Tax ("NRIT")

The 2019 SBB makes two changes on the existing Royal Legislative Decree 5/2004 governing this tax. These modifications will apply to tax periods starting on or after 1 January 2019, provided they did not end prior to the entry into force of the 2019 SBB.

The changes have been introduced to place a limit or cap on the deductions and credit that can be applied to lower the tax payable for NRIT by permanent establishments (PEs). They are essentially as follows:

- **Establishing, for NRIT purposes, a limit on deductions and allowances governed by the new Article 30-bis of Law 27/2014:** by virtue of this limit, tax liability for income attributable to PEs may be no less than 15% of the positive tax base. This limit on the applicability of deductions and allowances will apply only to those PEs that meet one or more of the following two requirements:
 - i) their net turnover was at least 20 million euros over the 12 months leading up to the date on which the tax period starts;
 - ii) they pay tax under the tax consolidation regime, no matter how much net turnover they generate.
- **The Bill draws a distinction between total tax liability (*cuota íntegra*) and net tax liability (*cuota líquida*) under Article 19 of Royal Legislative Decree 5/2004, governing tax liability for income attributable to PEs:** to place a limit on the applicability of CIT deductions and allowances on total tax liability for NRIT, the article draws a distinction between total tax liability (*cuota íntegra*) and net tax liability (*cuota líquida*). As originally drafted, Article 19 only addressed the concept of total tax liability.

Further, the new drafting explains what concepts can be deducted in respect of the total tax liability and net tax liability. More to the point, the new law states that only the deductions and allowances provided for in the CIT Law can be applied to the total tax liability, though without this bringing the tax liability into negative figures. Meanwhile, the only concepts that can be deducted from the net tax liability are withholdings, payments on account and split payments already made.

VI. Tax on Economic Activities (“TEA”)

Title VI, which contains the tax rules of the 2019 SBB, introduces a series of changes to Royal Legislative Decree 1175/1990, specifically in relation to the approved tariffs contained in Group 15 of Section One. The changes are as follows:

- The title of Group 15 is to be changed to “Production, transportation, distribution and sale of electrical power, gas, steam and hot water”.
- The titles of Groups 151 and 152 are to be modified, including the term “sale” in both cases.
- Headings 151.6 (Sale of electrical power) and 152.2 (Sale of gas) are to be created.
- The rate contained under Heading 152.1 will be determined solely on the basis of Kw.

VII. Special taxes

The 2019 SBB introduces the following amendments in relation to the tax on hydrocarbons and the special tax on electricity:

- **Tax on Hydrocarbons:** the tax rates on diesel fuel for general use and biodiesel have been raised. The Bill also modifies the State-levied rate for determining the partial rebate of tax on hydrocarbons for diesel fuel used by certain professions.
- **Special Tax on Electricity:** the Bill includes a new exemption for electricity consumed on ships and generated on board.

We trust you find this information useful. Please remember that all of us at Roca Junyent are on hand to answer any questions you may have.

Yours faithfully,

Tax Department at Roca Junyent

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