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MARBELLA-MADRID

Proposed modifications for the Corporate IncomeTax

On Wednesday, 3 July 2013, the Official Parliament Gazette published the following two bills of law, introducing important new tax measures in Spain:

This note briefly summarizes the new Corporate Income Tax (CIT) measures contemplated in each of these bills of law. Furthermore, it should be taken into account that these bills of law could undergo significant changes during parliamentary debate.

Non-deductibility of portfolio impairment of participations held in both Spanish as well as foreign companies, as well as of the losses incurred by permanent establishments abroad.

For tax periods starting as of 1 January 2013, one of the most important changes proposed is the indefinite elimination of the deductibility of the loss in value of participations held in the capital or equity of other entities, regardless of whether or not they are resident in Spain. It has been also eliminated the deduction for losses incurred through permanent establishments located abroad, as well as those obtained by companies belonging to joint ventures ("UTEs") operating abroad. These losses will become deductible upon the transfer or closure of the permanent establishments or UTEs.

This measure implies not only the elimination of article 12.3 of the CIT Law approved, but also other important modifications and adaptations of this Law. For example, we can mention the introduction of modifications in article 21 of the CIT Law (exemption for dividends and other foreign source income obtained on the transfer of shares representing the participation in foreign companies), article 22 of the CIT Law (exemption for income obtained through permanent establishments located abroad), article 30 of the CIT Law (tax credit to avoid internal double taxation), articles 31 and 32 of the CIT Law (tax credits to avoid international double taxation), as well as various articles on the special CIT tax consolidation regime and the special tax regime for mergers and other corporate restructuring operations.

Limitation on the deductibility of losses incurred on the transfer of participations or permanent establishments between group entities

The limitation on the impairment of participations in the capital or equity of other entities is accompanied by certain anti-avoidance measures. This includes the non-deductibility of losses incurred on the transfer to group entities of securities representing participations in the capital or equity of other entities. In these cases, the loss will be allocated either in the tax period in which such securities are transferred to unrelated third parties, or when the transferor or the acquirer ceases belonging to the group. A similar rule is foreseen for the losses incurred on the transfer of permanent establishments.

On the other hand, in relation with this subject, the bill would establish that the losses obtained on the transfer of a participation in an entity, whether or not it is resident, will be reduced by the amount of the dividends or participations in profits received from the participated entity. Please take into account that the current wording of the bill does not specify that this rule will be applied only if the dividends entitle the recipient to a full tax credit for double taxation (article 30.2 of the CIT Law) or to an exemption (article 21 of the CIT Law) or a tax credit to avoid double international taxation (article 32 of the CIT Law). Again, the bill contains a similar rule for the losses incurred on the transfer of a The bill maintains the cases in which this minimum payment on account is not applicable.

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Extension of temporary measures to 2014 and 2015

In the last few years, various transitory measures have been introduced aimed at reducing the public deficit, the bill would extend a great number of these measures to tax periods beginning in 2014 and 2015. The measures which the bill would extend are the following:

- Limit on the compensation of tax losses depending on turnover and net sales. If this limit is applicable, it could imply that the taxable base prior to compensation can only be reduced by 25% or 50%, depending on the company's net sales. A new measure is added foreseeing that "For purposes of applying the aforementioned limits, the calculation of the taxable base prior to compensation of tax losses will not take into account the income corresponding to arrangements with the taxpayer's creditors approved in a bankruptcy procedure regulated by Law 22/2003 of 9 July on Bankruptcy".

- Limitation on the deduction of financial goodwill arising on the acquisition of participations in non-resident entities (article 12.5 of the CIT Law).

- The deduction of explicit goodwill (articles 12.6 and 89.3 of the CIT Law) would be limited to 1% annually.

- The deduction of intangible fixed assets with an indefinite useful life (article 12.7 of the CIT Law) would be limited to 2% annually.

- The application of free depreciation for assets acquired between 2009 and 2012 which complied with the requirements of the applicable legislation would be limited to 20% or 40% of the taxable base prior to its application and to the application of tax losses from previous years.

Some measures will only be extended to tax periods beginning in 2014:

- In 2014, those companies with a turnover during the year preceding the tax period of more than 6,010,121.04 euros would continue to apply the increased payment on account rates, which depend on the net sales obtained in said twelve month period. Thus, companies which use the tax base method for calculating their payments on account will continue to use the following rates: 21%, 23%, 26% and 29%2.

Other measures affecting CIT payments on account that would be extended to tax periods beginning in 2014 and 2015 like:

- Taxpayers would be obliged to include 25% of the dividends and foreign source income to which the exemption provided in article 21 of the CIT Law is applicable, in the payment on account base calculated using the tax base method.

- Taxpayers obliged to apply the tax base method would be obliged to make a minimum payment on account of 12% (6% in certain cases) of the positive result of the profit and loss account of the first 3, 9 and 11 months of the calendar year (or, in cases in which the tax period does not coincide with the calendar year, of the part of the tax period elapsed since its beginning until the day before the commencement of each payment on account period). This amount cannot be reduced by the tax losses pending compensation, nor by tax allowances or withholdings (although it could be reduced by payments on account made previously during the same tax period).

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Other foreseen CIT measures

The bill would also introduce the following CIT measures:

- Tax credit for investments in cinematic productions and audiovisual series: they would have an indefinite duration. Likewise, the tax credit base would be increased by including copies and publicity expenses borne by the producer.

- Tax allowance for income obtained in Ceuta and Melilla: this tax allowance is modified in order to bring it in line with the one existing for Personal Income Tax purposes and to establish minimum rules making its practical application easier.

- Financial leasing contracts: the exception to the requirement that the part of the lease installment that corresponds to the recovery of the cost of the good be constant or increasing is extended to 2015, inclusive.

- Tax credit for the investment of profits: the bill would approve a new tax credit for small and medium size enterprises of 10% (5% for micro enterprises) of before- tax profits reinvested in new material fixed assets or real estate investments to be used in the business activity, provided that certain requirements are fulfilled (e.g. allocation of a restricted reserve as long as the Law obliges taxpayers to maintain the assets in which the investment was made). This measure would affect profits generated in tax periods beginning as of 1 January 2013.

- The bill specifies that those companies which opted to update their balance sheets as foreseen in article 9 of Law 16/2012 dated 27 December, in cases of transfers of real estate, would reduce the indexation foreseen in article 15.9 of the CIT Law by the amount of the revaluation.

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Bill supporting entrepreneurs and their expansion abroad

Tax credit for Research and Development (R&D)

Companies would be able to choose to not apply the limit established in article 44 of the CIT Law (25% or 50%, depending on the circumstances) for the R&D tax credit generated in tax periods beginning as of 1 January 2013. Companies choosing this option would apply the R&D tax credit reduced by 20%. A significant new measure providing the possibility of cashing in on R&D tax credits; that is, companies which cannot apply this tax credit because of an insufficient amount of CIT due could ask the Administration to pay them the amount of the R&D tax credit. The amount of the tax credit applied or paid as per the preceding two paragraphs could not jointly exceed 3 million euros annually. This limit will be calculated on a group level for companies under the scope of article 42 of the Code of Commerce.

Certain requirements must be fulfilled in order to apply this option: i) at least one year must have elapsed after the tax year in which the tax credit was generated but not applied, ii) the average number of staff (either total staff, or the staff assigned to R&D activities) must be maintained during 24 months after the end of the tax year, iii) an amount equivalent to the R&D tax credit applied must be invested in R&D activities and iv) the taxpayer must obtain a reasoned report on the qualification of the activity as R&D or a previous valuation agreement on the expenses and investments corresponding to the R&D project.

Reduction of income derived from certain intangibles ("Patent box")

The article 23 of the CIT Law, would now be called "Reduction of income derived from certain intangibles". The main new features of this regime, commonly called "Patent Box", are the following:

- The reduction will be applied to the net income (instead of the gross revenues) derived from intangibles, and will be 60% (instead of 50%) of such net income.

- The time limit on the application of the reduction would be eliminated. In other words, the bill would eliminate the reference stating that the reduction would not be applicable as of the tax period following that in which the revenues derived from the assignment exceed the cost of the asset created, multiplied by six.

- With respect to the requirement that the intangible asset be created by the company, the bill specifies that the company's participation in its creation must represent at least 25% of its cost.

- The reduction could be applied to the income obtained on the transfer of intangible assets, provided that the transfer does not take place between group entities as defined by article 42 of the Code of Commerce. This reduction would be incompatible with the reinvestment tax credit.

- The bill eliminates the reference stating that in operations between tax consolidated entities, the revenues and expenses derived from the assignment will not be eliminated in order to calculate the tax group's taxable base. On the contrary, the bill establishes the obligation to document (article 16.2 of the CIT Law) the operations that give rise to the application of the Patent Box regime in cases involving tax consolidated entities.

- The bill establishes the possibility of requesting the Tax Administration to adopt advance pricing agreements in relation to the revenues derived from the assignment of assets and the associated expenses, as well as on the income generated on the transfer. Likewise, it foreseen the possibility of requesting a prior agreement qualifying the assets as belonging to the category of intangibles eligible for application of this tax incentive.

About the Firm

P&C is an independent tax and legal advisory firm established in 2006 by professionals who, until then, had developed their professional careers in major national and international firms. The team gathered and decided to start this firm as they were convinced that their personal experience and the advice they could give was extremely valuable.

P&C advises its clients both in high value-added operations and in day-to-day processes like national and international compliance and paper work, with total availability and commitment to their business and personal results using English as working language.

P&C founding members prove more than 10 year experience in managing national and international projects in collaboration with other professionals from any other sector or nationality, when the client's interest so requires. P&C structure and experience enables them to offer an excellent **price-service** ratio.

Partners:

Miguel Ángel Peral: Has a Bachelor of Law specialized in Internacional Law by the University San Pablo CEU in Madrid and a Master Degree in Private Law. He has knowledge and experience in all legal areas, specialized in Real Estate, Commercial and Inheritance or Succession law. As an Oficial Property Manager, registered and recognized by the Malaga Association of Property Managers, he is responsable for this mentioned area.

From 2001 until 2003 he devoloped his career in Forum Abogados C.B, one of the most important lawfirms in Marbella, specialized in Real Estate and Mortages law. From 2003 until 2004 he worked at Carretero Abogados, another specialized Real Estate lawfirm. At 2005 he founded Peralco Abogados, that has turned into into the actual P&C Tax and Legal Advisors.

Elena Cabello: Has a Bachelor of Law and a Master Degree in Tax Advisory in ICADE. She has knowledge and experience in all legal areas, also as an Official Certificate and Registration, Malaga Outsourcing Managers manages de accounting and compliance work.

Co-Founder at P&C Legal and Tax Advisors, she is in charge of developing all financial, outsourcing and traffic work. From 2002 until 2003 she worked at De la Riva, Burgos & Ortega Lawfirm in Marbella. From 2004 until 2005 she developed the Mortages area at Barclays Bank, being responsible for all Mortages formalized within this financial entity around Málaga.

Jose Manuel Peral: Has a Bachelor in Business Administration, a Master Degree of tax advisory by the IE, and a MBA degree by the Business School EOI. He has knoledge and experience in all tax areas, specially of International Tax, Corporate Income Tax, VAT and Personal Income.

Co-Founder at P&C Legal and Tax Advisors, he is head of the tax area. He has developed his career at PriceWaterHouseCoopers, the most important advisory company in the world, doing tax for audits and international tax advisory, Grant Thornton, fourth biggest audit company in the world, and from 2011 he has been responsible for the International tax and Compliance area at the international cost optimization company Lowendalmasai.

In addition, he has been involved in other projects like G11Futbol in Uruguay or Jewwe (Jewish Social Network).

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