CUATRECASAS

Tax Law

October 2021

CORPORATE INCOME TAX (“CIT”)

- Spanish Supreme Court judgment on the deduction of advertising costs to promote events of exceptional public interest
- Spanish Supreme Court judgment on offsetting tax loss carryforwards
- Central Economic and Administrative Tribunal (“TEAC”) resolutions refining the criteria on offsetting tax loss carryforwards
- General Directorate of Taxes (“DGT”) resolution on the effects on the capitalization reserve of distributing interim dividends charged against the profits for the financial year
- DGT resolution on transferring shares in a company engaging in the production, transmission and distribution of electricity
- TEAC resolutions on the maximum amount for offsetting tax loss carryforwards in corporate income tax payments on account

PERSONAL INCOME TAX (“PIT”)

- Spanish Supreme Court judgment on the calculation base for the deductible expense of annual depreciation of a property acquired free of charge
- Judgment of the National High Court. Residence of spouse and underage children

PROPERTY TRANSFER TAX AND STAMP DUTY (“ITPAJD”)

- Binding resolution of the DGT on the taxable base for stamp duty on novations of mortgage loans involving the extension of the maturity date
- Spanish Supreme Court order on canceling a financial lease due to the early exercise of the purchase option

VALUE ADDED TAX (“VAT”)

- Spanish Supreme Court judgment on banning the vertical direct effect of EU directives
- TEAC resolution extending to collective investment funds its doctrine on the unlawfulness of including pension funds in the Register of Large Enterprises (*Registro de Grandes Empresas*)
- CJEU judgment on Case C-294/2020, of September 9

OTHER DEVELOPMENTS

- Form 720: potential breach of EU law

Corporate income tax ("CIT")

Spanish Supreme Court judgment on the deduction of advertising costs to promote events of exceptional public interest

The Spanish Supreme Court has changed its position regarding the basis for deducting advertising and promotional expenses incurred on publicizing events of exceptional public interest when the advertising is placed on product packaging.

Specifically, three judgments issued by the Supreme Court determined that the deduction must cover the entire cost of the packaging on which the advertising or promotional information is included or inserted, and not just the additional cost incurred by the company to include the specific advertising on the packaging.

This change in the Spanish Supreme Court's position could allow the amount of the applicable basis of deduction to be increased.

For further details, see our *Finance and Tax Legal Flash of September 2021*.

Spanish Supreme Court judgment on offsetting tax loss carryforwards

In its *judgment dated July 22, 2021*, the Spanish Supreme Court issued a ruling regarding the adjustment of a non-statute-barred period, but relating to statute-barred years, as a motion was filed to adjust self-assessments going back 10 years in which tax base calculation errors were detected. The aim was to access tax loss carryforwards that would be available for offset in the non-statute-barred period.

In the case examined by the Court, in October 2015, the taxpayer liable for corporate income tax requested an adjustment of the corporate tax return for the 2012/13 period to include tax loss carryforwards from previous financial years (2004/05, 2005/06, 2007/08, 2008/09 and 2009/10) that had not been included in those years and that derived from accounting restatements that were improperly applied (and would have resulted in a negative adjustment to the corporate income tax base).

The Spanish tax authorities determined that the party's right to the adjustment of the self-assessments for financial years 2004/05, 2005/06, 2007/08, 2008/09 and 2009/10 had become statute-barred and stated that it was inadmissible to recognize in 2012/13 those carryforwards from earlier years not previously reported.

The Spanish Supreme Court reached the following conclusion: "*The motion to adjust the self-assessment for a year that is not statute-barred, which is possible in the case here with respect to 2012-2013, does not allow the content of that adjustment to consist of the* ex novo *recognition of tax loss carryforwards allegedly generated in statute-barred years and that were not included by the taxpayer in the self-assessments for those statute-barred years since the same period the law grants to the tax authorities to verify the non-statute-barred years cannot be offered to that party due to the absence of specific legislation or a general principle that could be applied to establish such an action. This means that the adjustment allows negative tax bases to be offset against positive tax bases in the year, but not to also create tax loss carryforwards for offset.*"

The Supreme Court therefore considers that

the tax authorities' right to verify tax loss carryforwards going back 10 years (beyond the 4-year statute of limitations) in accordance with article 66.bis.2 of the General Tax Act ("GTA") does not extend a similar right to the taxpayer if an adjustment is to be made to a tax return relating to a year that is not statute-barred, increasing (and making an offset available, if appropriate) the tax loss carryforwards shown to exist in the statute-barred years (falling within the 10-year period).

Central Economic and Administrative Tribunal ("TEAC") resolutions refining the criteria on offsetting tax loss carryforwards as a tax option

The Central Economic and Administrative Tribunal ("TEAC") used its decision *dated July 22, 2021* to refine the position it adopted in its *ruling dated April 4, 2017*, as it had previously done in its *prior final ruling dated January 16, 2019*, in a case in which a company had not offset tax loss carryforwards or had offset less than the permitted maximum, and the amount of the tax loss carryforwards available for offset increased as a result of a decision by an administrative review body.

In this case, the TEAC resolved that the company, within the framework of tax application procedures, should be given the option to offset a amount of tax loss carryforwards higher than was initially applied, despite the amounts of the tax loss carryforwards it did apply not being available.

The TEAC concluded that the content of article 119.3 of the GTA must be interpreted and understood on a r*ebus sic stantibus* basis ("things standing thus" or unless changes occur). Accordingly, if the situation in which the initial option was applied later changes because the tax authorities make an inappropriate decision (reducing tax loss carryforwards through an action that the Courts later reverse), it must be assumed that changes can be made to the initially applied option.

However, the TEAC clarifies that the possibility of a new application arises only with respect to the "new" element appearing in the later situation compared to the initial situation: what was previously applied is subject to article 119.3 of the GTA and the interpretation provided for in the decision of this Central Court on April 4, 2017. This means that what actually arises is not so much a modification or change in the initial application, but rather the possibility of applying something new that was previously not available, but only when the change in the situation was ultimately caused by improper action by the tax authorities.

Finally, in its *ruling dated September 22, 2021* the TEAC reiterates its position relating to the fact that the offset of tax loss carryforwards is a tax option that must be applied at the time the self-assessment or return is filed within the regulatory deadline in a case where a taxpayer filed a corporate income tax self-assessment outside of the regulatory filing deadline (two days late). Although the TEAC recognizes that its decision of April 4, 2017 was canceled by the judgment issued by the *National High Court on December 11, 2020*, it concluded that the higher court's judicial ruling is not final since an appeal for reversal has been filed with the Spanish Supreme Court. It therefore maintains the position expressed in its ruling and denies the possibility of offsetting any tax loss carryforwards in the self-assessment filed after the deadline.

General Directorate of Taxes ("DGT") resolution on the effects on

the capitalization reserve of distributing interim dividends charged against the profits for the financial year

The General Directorate of Taxes ("DGT") has issued binding resolution *V1952-21* on how distributing a dividend charged against the profits for the financial year affects the calculation of the increase of a company's capital, for the purposes of the capitalization reserve.

The DGT concluded for these purposes that "(..) *when calculating the increase in capital, the profits for the financial year are not taken into account and so the change in own funds deriving from those profits does not affect the reduction basis.*

Therefore, given that the amount of the reduction would not be determined according to whether the profits for the year were positive or negative, the distribution of dividends in 2021 charged against those profits for that same year will likewise have no effect on the reduction basis used for the 2021 capitalization reserve, but would affect the calculation of the increase in capital and reserves for the following tax year."

The DGT's conclusion is based on the fact that the interim dividend will reduce the profits recorded in the financial year, meaning that it should reduce profits for the year, which are excluded from the calculation, and not the final equity for the year in which the dividend is distributed. As a result, this reduction in profits will affect the calculation of the capitalization reserve in the following tax year.

DGT resolution on transferring shares in a company engaging in the production, transmission and distribution of electricity

The DGT has issued binding resolution *V2265-21* regarding the application of the exemption relating to income from the transfer of shares representing the equity of the companies as defined by article 21 of the Corporate Income Tax Act.

Specifically, the DGT was requested to provide a response regarding the application of this exemption to the income from a transfer by a company setting up a project to build a solar energy plant in which it will carry out activities involving energy production, transmission and distribution (development of a solar energy plant). It should be noted that at the time of the transfer, the company had completed the first phase of the project, consisting of filing applications for and receiving of all of the permits necessary to build the facility.

The DGT concluded that the income deriving from the transfer of the shares is not exempt, arguing that the transferred company is affected by the limitation on holding companies established under article 21.5.a) of the Corporate Income Tax Act due to the fact that the company had not materially begun the development of the solar energy plant, but only completed the process of obtaining the licenses and permits necessary to build the facility.

The DGT thus considers that "*neither the mere intention or will to carry it out, nor simple preparatory actions or those that are intended to begin the effective performance of the activity represent a material start of that activity*."

With this decision, the DGT seems to modify its position presented in its resolutions *V3707-15* and *V2931-16*, extending the existing policy regarding real estate development activity to the area of renewable energies.

TEAC resolutions on the maximum amount for offsetting tax loss carryforwards in corporate income tax payments on account

In two recent rulings, obtained under legal claims handled by Cuatrecasas, the TEAC

concludes that the settlement period for payments on account cannot be confused with the taxpayers' tax period, thus ruling out the possibility of proportionally reducing the minimum €1 million amount of the offset of tax loss carryforwards based on the settlement period for payments on account, as the tax authorities had admitted at times.

For further details, see our *Finance and Tax Legal Flash of October 2021*, in which we analyze this and other matters of interest concerning the reduction of payments on account and the recovery of their financial effect.

PERSONAL INCOME TAX ("PIT")

Spanish Supreme Court judgment on the calculation base for the deductible expense of annual depreciation of a property acquired free of charge

The Spanish Supreme Court has established an important policy determining the basis of calculation for the amounts to be deducted as depreciation when a property has been acquired for no consideration (through inheritance or donation).

It should be noted that personal income tax legislation requires that the depreciation of property must be calculated by applying a 3% rate to the higher of the following values: (i) the acquisition price paid, and (ii) the cadastral value, excluding land in both cases.

It its *judgment dated September 15, 2021*, the Supreme Court ruled against the policy previously maintained by the DGT (in rulings *V3404-19*, *V3410-19* and *V1903-21*, among others) regarding the concept "acquisition price paid." The DGT has traditionally concluded that this price, with respect to properties acquired for no consideration, only consisted of the payment of expenses and taxes inherent to the non-onerous acquisition, which would relate to the construction of the property itself (and, where appropriate, the cost of any investments or improvements made).

However, the Spanish Supreme Court has resolved otherwise, concluding that the basis of calculation of depreciation must also include the reported (or verified) value reported for inheritance or gift tax purposes, although still excluding land.

Accordingly, "*The 'acquisition price paid' applies to acquisitions for consideration and for no consideration and, in both cases, it must include the value of the asset, the calculation of which depends in each case on the characteristics of the manner of acquisition. For acquisitions for consideration, the actual value of the asset is applied, while for acquisitions for no consideration, the actual amount of the value is calculated in accordance with the rules governing inheritance and gift tax, i.e., the amount set out in the donation or inheritance deed, or the value verified by the authorities.*"

Based on this judgment from the Spanish Supreme Court, it may be advisable to file for an adjustment of personal income tax returns in which the administrative criteria has been applied to request the refund of any undue amounts paid.

Judgment by the National High Court. Residence of spouse and underage children

In its *judgment dated March 4, 2021*, the National High Court ruled on the tax resident status in Spain of taxpayer who remained in Spain until the school year of his underage children ended.

The background to the case reveals that the taxpayer was located outside of Spain for more than 183 days due to having been transferred by his employer to the United Kingdom. The taxpayer provided a tax

residency certificate issued by the British tax authorities.

However, the Spanish tax authorities considered that he maintained his status as a tax resident due to the fact that his spouse and underage children remained in Spain until the end of the school year, i.e., his family moved abroad at the end of the school year, after being in Spain for more than 183 days.

The National High Court followed (with respect to non-resident income tax) the decision reached by the High Court of Justice of Madrid (with respect to personal income tax), concluding that the taxpayer cannot be considered a tax resident in Spain since he remained in Spain for less than 183 days and the center of his economic interests was not located in Spain despite the fact that his nuclear family remained there for more than 183 days for justified reasons.

Property transfer tax and stamp duty ("ITPAJD")

Binding resolution of the DGT on the taxable base for stamp duty on novations of mortgage loans involving the extension of the maturity date

The DGT has issued binding resolution V2305-21, laying down significant criteria regarding the taxable base for stamp duty on novations of mortgage loans involving the extension of the maturity date.

It should first be noted that the DGT had previously argued that the taxable base for stamp duty on novations of mortgage loans was calculated based on the total secured liability.

However, the Spanish Supreme Court reached a decision in this respect in its judgment dated March 13, 2019, concluding that "*the taxable base must be calculated in accordance with the material content of the taxable event, which, in the case of a mere novation that modifies the mortgage loan included in a public deed, is the content of the valuable financial clauses that define the economic capacity that can be taxed.*" The Supreme Court has taken this same position in its judgments dated *March 4, 2020*, *July 23, 2020* and *September 17, 2021*, among others.

However, neither the Spanish Supreme Court nor the DGT had specified the manner of quantifying the economic content of the modified financial clause.

In view of this, the DGT has now issued binding resolution *V2305-21* in which it reaches a decision regarding the practical application of the Spanish Supreme Court's criteria and sets out the rules applicable to novations of mortgage loans that involve an extension of the maturity date.

Specifically, the DGT sustains that "*the taxable base in notary deeds for mortgage loan term extensions that are subject to and not exempt from stamp duty on notary documents, the amount of the stamp duty will be based on 'the economic content of the quantifiable financial clauses defining the economic capacity of taxpayers ultimately subject to taxation,' which, in the case at hand, seems to include any additional interest and expenses arising from the term extension. This is all without prejudice to any verification that the competent settlement office may perform based on the documentation presented.*"

The DGT quantifies the taxable base and eliminates any reference to the total secured mortgage liability (the figure based on which the taxable base for mortgage loans is configured).

This decision is particularly relevant for refinancing agreements that change the loan term and in which the lender is not a financial institution, which may benefit from the

stamp duty exemption established under article 9 of Act 2/1994, of March 30, on the subrogation and modification of mortgage loans.

Spanish Supreme Court order on canceling a financial lease due to the early exercise of the purchase option

The Spanish Supreme Court admitted appeal for reversal 7987/2020, through *an order dated July 7, 2021*, filed with the legal representation of Cuatrecasas, setting out "*how the taxable base for the tax on transfers of assets for consideration and stamp duty on documented legal transactions is calculated in cases in which a public document is formally executed to exercise a purchase option that involves the early cancelation of a finance lease agreement. In particular, specification of whether the taxable base must take into consideration the installments pending payment or only the residual value of the transferred asset.*"

The Spanish Supreme Court will reach a decision as to whether the cancelation of a finance lease due to exercising the purchase option early will cause the taxable base for stamp duty to include the installments pending payment or only the residual value.

Value added tax ("VAT")

Spanish Supreme Court judgment on banning the vertical direct effect of EU directives

In its judgments dated *June 10, 2021*, and *June 14, 2021*, the Spanish Supreme Court ruled on the vertical direct effect principle of the primacy of EU law over national law.

The question revolves around a case in which the previous wording of the VAT Act was applicable (article 5), which established that commercial companies were, in all cases, businesses. However, regional tax authorities invoked the direct effect of European Union Directives (article 4 of the Sixth Directive and article 9 of Directive 2006/112/EC) to argue that transactions carried out by the affected company must be considered not subject to VAT and, therefore, subject to transfer tax.

The Supreme Court ruled that the state cannot invoke the vertical effect of the Directive to the detriment of the taxpayer. It does not consider admissible that the state should invoke the direct application of a directive on an individual, thereby generating obligations for that party, as a result of non-compliance in transposing that directive.

It concludes that, despite the fact that VAT legislation must be interpreted in accordance with EU law, as applied by the CJEU, "*the direct effectiveness of the directive cannot impose obligations on an individual towards the state when the state did not execute that directive within an adequate term or in an adequate manner. The state cannot justify its reasons based on in its own failure to comply with and apply the directive.*"

TEAC resolution extending to collective investment funds its doctrine on the unlawfulness of including pension funds in the Register of Large Enterprises (*Registro de Grandes Empresas*)

The TEAC has issued *Ruling RG 6051/2019, of September 22, 2021* in which it resolves the question as to if collective investment funds must be included in the Register of Large Enterprises based on whether they carry out a business activity and in accordance with the volume of their transactions.

This resolution represents a change compared to other resolutions issued by the TEAC regarding the same matter, dated *April 22, 2021*, March 23, 2021, and November 12, 2019.

In the case submitted for the review, the TEAC analyzed the case of a collective investment fund that was notified by the Large Enterprise Management Unit that it was included in the Register of Large Enterprises because its volume of transactions, calculated in accordance with article 121 of the VAT Act, exceeded €6,010,121.04 in the immediately preceding calendar year.

The TEAC admitted the claim filed by the investment fund following the doctrine established by the court itself with respect to the consideration granted to pension funds for the purposes of including/excluding them from the Register of Large Enterprises (*Resolution RG 3722/2018, of June 21, 2021*).

The Register of Large Enterprises consists of taxpayers whose volume of transactions, calculated in accordance with article 121 of the VAT Act, exceeds €6,010,121.04 in the calendar year immediately preceding its registration. The TEAC concluded for these purposes that collective investment funds are not considered to carry out their own business activity involving the organization of means of production to engage in the production and distribution of products in the market, despite being considered liable for corporate income tax under a special taxation system.

The TEAC considers that income from dividends from variable-rate securities, fixed income securities and other income from trading securities should not be included in their volume of transactions because that income does not form part of income received from a business activity for VAT purposes, as decided by the Court of Justice of the European Union in several judgments cited in the resolution.

CJEU judgment on Case C-294/ 2020

In its judgment of September 9, 2021 the CJEU ruled on the possibility that a taxpayer provide documentation in procedural phases subsequent to an administrative decision issued with respect to a request for a VAT refund, in the light of the Eighth Directive and the principle of tax neutrality.

The judgment states that the content of the Eighth Directive (i.e., that applicable to taxpayers not established in the country) *"does not oppose a national law by virtue of which the right to a refund of VAT can be denied when the taxpayer does not provide, without reasonable justification and despite requests having been issued, documents that offer evidence that the material requirements have been met prior to the Administration adopting its decision."*

However, it then also recognizes that "*that same content does not oppose Member States admitting the presentation of such evidence after adopting that decision,*" thus allowing both possibilities in accordance with EU law.

The basis for reaching that conclusion can be found in the principle of procedural autonomy of Member States in all matters not regulated by directives, provided that they respect the principles of equivalence and effectiveness, which must be verified by the jurisdictional body issuing the consultation (in this case, the National High Court).

The judgment also resolves another pre-judicial question relating to the possible classification of that conduct (i.e., providing the documentation requested by the tax authorities after a negative resolution has been issued) as abusive, and it understands that there is no abuse of the law in this conduct since it did not result in a tax

CUATRECASAS

advantage in violation of the purpose of the content of the Eighth Directive and it did not have the sole purpose of obtaining such an advantage.

The practical implications that this judgment may have on the Spanish legal system will depend on the final decision reached by the National High Court and, foreseeably, the Spanish Supreme Court in the final instance. The former is now free to reach the decision it considers best based on the content of the judgment being analyzed.

Other new developments

Form 720: potential breach of EU law

On July 15, 2021, the *conclusions of the advocate general on matter C-788/19, European Commission vs. Kingdom of Spain*, were published with respect to the possible violation of EU law by the Spanish legislation governing the obligation to provide information on assets and rights located abroad (Form 720).

The advocate general concludes that Spanish legislation violates EU law with respect to:

- The classification of the value of "new" bank accounts—those opened on or after January 1, 2016—as an unjustified capital gain due to not having been reported or reported after the deadline in Form 720, without any possibility of invoking the statute of limitations.
- The proportional fine of 150% associated with the tax liability deriving from the unjustified capital gain due to the failure to comply with the obligation to report "new" bank accounts within the deadline, or make a report after the deadline.
- The fixed fines deriving from the failure to file Form 720 or an incorrect or inaccurate reporting of data, or filing the form after the deadline.

In the coming months, the conclusions of the advocate general are likely to be deliberated by the CJEU, which will be followed by the publication of its judgment.

For further information, please see our *Finance and Tax Legal Flash of July 2021*.

For additional information, please contact Cuatrecasas.

©2021 CUATRECASAS

All rights reserved.

This document is a compilation of legal information prepared by Cuatrecasas. The information and comments in it do not constitute legal advice.

Cuatrecasas owns the intellectual property rights over this document. Any reproduction, distribution, assignment, or any other full or partial use of this document is prohibited, unless with the consent of Cuatrecasas.