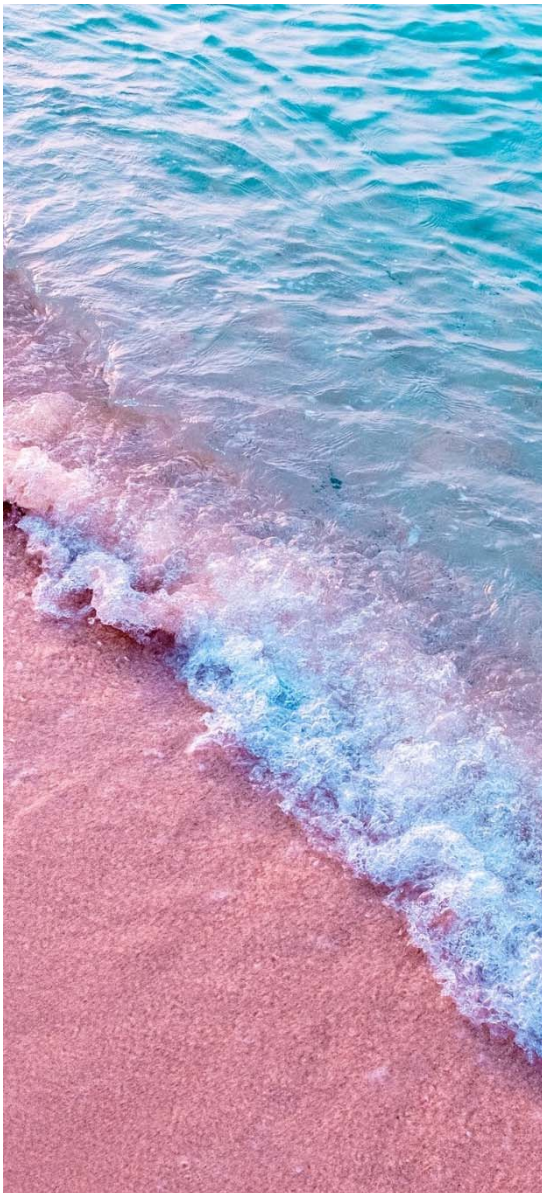

Special tax system in the Balearic Islands

Approval and publication in the Official Gazette of the regulatory development affecting the 2023 tax period

Spain - Legal flash

July 25, 2024



Key aspects

This legal flash summarizes some of the most noteworthy aspects of the special tax system in the Balearic Islands, which offers the following tax incentives:

- A reserve for investments in the Balearic Islands
- A special regime for industrial, agricultural, livestock and fishing companies

The much awaited regulatory development provides solutions to several issues that raised certain doubts.

The new tax regulation is applicable to tax periods starting on or after January 1, 2023.



Introduction

On July 24, 2024, the Official Gazette of the Spanish State published [Royal Decree 710/2024, of July 23, approving the implementing regulation on the special tax system in the Balearic Islands](#) (the “**Regulation**”). More specifically, the Royal Decree approves the regulatory development of two measures enacted under [Act 31/2022, of December 23, on the General State Budget for 2023](#), as analyzed in our [Legal flash | Tax developments for companies](#):

- **A reserve for investments in the Balearic Islands**, allowing the taxable base for corporate income tax (“**CIT**”) to be reduced by up to 90% of profits made in the Balearic Islands, as long as they are allocated to certain investments.
- **A reduction applicable to the part of the total tax liability corresponding to income resulting from the sale of tangible assets produced in the Balearic Islands, inherent to industrial, agricultural, livestock and fishing activities**, if certain requirements are met regarding the average workforce, with a higher reduction being applicable if there is an increase in the average workforce.

These measures have entered into force for **tax periods starting on or after January 1, 2023** (and until the tax period beginning before December 31, 2028), which means that the Regulation affects the **CIT self-assessment, the filing deadline of which will soon expire** for companies and tax groups whose fiscal years coincide with the calendar year.

Generally speaking, the Regulation is not far removed from the text submitted for public information in March this year, and it practically mirrors the regulatory development of the investment reserve in force in the Canary Islands (approved under Royal Decree 1758/2007, of December 28, approving the implementing regulation of Spanish Act 19/1994, of July 6, amending the Economic and Tax Regime of the Canary Islands, on issues related to tax incentives for indirect taxation, the reserve for investments in the Canary Islands, and the Canary Islands Special Zone).

Reserve for investments in the Balearic Islands

The creation of a reserve for investments in the Balearic Islands (“**RBI**”) allows CIT and non-resident income tax (“**NRIT**”) payers to apply up to a **90% reduction to the taxable base for the part of the profits** made in the same period that are not subject to distribution, as long as the profits **were generated in establishments located in the Balearic Islands**.

This incentive also **extends to personal income tax (“PIT”) payers**, through a reduction of the total tax liability. To apply this reduction, taxpayers must calculate their net return using the direct estimation method and keep their accounts as provided under the



Spanish Commercial Code.

Amounts allocated to the RBI **must be materialized within three years in any of the following investments:**

- A. The acquisition of tangible and intangible fixed assets, assets contributing to the protection and improvement of the environment of the territory of the Balearic Islands, and research and development expenses resulting from research, development and innovation activities.
- B. The creation of job positions directly related to the investments described in point A above, occurring within six months from the date the investment becomes operational.
- C. The subscription of shares issued by companies operating on the archipelago as a result of their incorporation or capital increase.

The regulatory development of the RBI is divided into four sections: (i) general provisions; (ii) investments that may be allocated to the RBI; (iii) specific requirements imposed on certain investments; and (iv) special rules to apply the RBI.

We highlight the most noteworthy aspects of the Regulation:

- > Article 3.1 of the Regulation refers to article 22.3 of the Company Tax Act to determine when a company can be considered to be located in the Balearic Islands for tax purposes. Thus, an entity is considered to have an establishment on the islands if it *“has, on an ongoing or usual basis, facilities or workplaces in which it performs all or part of its activities, or if it performs them through an agent authorized to contract, in the name and on behalf of the taxpayer, that exercises this authority on a regular basis.”* In the case of NRIT payers, the definition of permanent establishment refers to article 13.1 of the consolidated text of the Non-Resident Income Tax Act, approved under Royal Legislative Decree 5/2004.
- > Thus, article 4.1 of the Regulation states that profits are considered to have been generated by establishments located in the Balearic Islands if they are earned through operations carried out using personnel and material means that have an impact on and complete a business cycle determining economic results. Article 4.2 of the Regulation, in line with the law, excludes any profits resulting from the transfer of assets the acquisition of which is used to materialize the RBI. However, the Regulation specifies that if the RBI partially materialized from an asset, the proportional part of the profit corresponding to the part of the acquisition value not resulting in the materialization of the RBI will be considered a profit not subject to distribution.
- > Under article 4.3 of the Regulation, to determine the undistributed profit that may be attributed to establishments located in the Balearic Islands—based on



which the reduction is calculated— and to be able to apply the 90% limit of the part of the profit to be allocated to the reserve, the accounting results will be taken into account, i.e., profits after tax. Therefore, the correct application of the RBI entails applying a two-equation system (as is the case with the reserve for investments in the Canary Islands), as the tax calculation depends on the applied RBI and vice versa.

- Article 6 of the Regulation provides the definitions set out under regulations on commercial areas subject to a refurbishment process, tourist activities and tourist establishments that are essential for the RBI to be materialized on land.
- Article 8 of the Regulation regulates the substantiation of the RBI being materialized in investments contributing to the improvement and protection of the environment. Specifically, it provides that a certificate validating the investment must be obtained. The certificate will be granted by the authorities and it must be issued before the deadline to submit the tax of the last tax period in which the taxpayer can materialize the RBI. If this validation is not achieved by the stipulated deadline, this will be considered a material defect that will result in the reimbursement of previously reduced amounts. The rule has made some new developments to the text submitted for public information.
- Article 11 of the Regulation sets out the calculation of changes to the average workforce for the purposes of materializing the RBI by creating job positions, indicating that the calculation must be made based on all of the taxpayer's establishments on the islands. Also, the job position need not be filled by a newly contracted worker. This provision also differs from the text submitted for public information.
- Article 14 of the Regulation allows the reduction to be applied proportionally when the acquisition value of the investments made by the investee company does not reach the total amount paid for the shares acquired by the taxpayer, thus dispelling all doubts in this regard.
- Article 15 of the Regulation provides further clarification with regard to the requirement to be fulfilled by lease properties in which the reserve is materialized.
- Finally, article 18 of the Regulation provides that the RBI may be materialized after December 31, 2028, as long as the allocation of the reserve linked to those investments has been carried out before that date.



Reduction applicable to industrial, agricultural, livestock and fishing activities

CIT and NRIT payers can apply a **reduction of 10% of the total tax liability corresponding to the profits resulting from the sale of tangible assets produced in the Balearic Islands by the payers themselves**, inherent to agricultural, livestock, industrial and fishing activities.

This incentive **will also be applicable to PIT payers** that calculate their net return using the direct estimation method and perform the same activities. Notably, article 25.1 of the Regulation establishes that taxpayers subject to any of the direct estimation methods (whether normal or simplified) can apply for this reduction. Also, if a company performs several activities, the reduction will only apply to profits deriving from activities entitling the company to the reduction (article 25.2 of the Regulation).

The application of the reduction in each tax period will require the company's **average workforce** in that period not to be less than the average workforce corresponding to the twelve months before the beginning of the first tax period in which the regime takes effect.

Also, the reduction **will be increased to 25%** in tax periods in which, as well as meeting the above requirement, the average workforce has increased by no less than one with respect to the average workforce in the previous tax period. This increase must be maintained for at least three years.

It is worth noting that with regard to fishing activities, and based on the legal requirement to include catches made in its fishing and aquaculture zone, article 26 of the Regulation lays down that deep-sea fishing boats must disembark from a Balearic Island port, and the catch must be manipulated or transformed on one of the islands. Moreover, persons or entities domiciled in the Balearic Islands or in other territories that are engaged in the production of these goods in the archipelago, by means of a branch or permanent establishment, may benefit from this tax reduction.

We also highlight that, under article 28 of the Regulation, subsidies and grants will not be included in the profit benefiting from the reduction unless they must necessarily be passed on to the sales price of the product to the end user.



Adaptation of the special tax system in the Balearic Islands to European Union law and monitoring its implementation

The RBI tax incentives applicable to agricultural, livestock, industrial and fishing activities **must respect the quantitative limits established by EU law regarding de minimis aid.**

Likewise, any aid received by a beneficiary of the special tax system in the Balearic Islands and grants considered state aid must be disclosed in an **informative tax return. Form 283** is currently being processed for this purpose.

We highlight the following aspects of the regulatory development:

- > In the case of reductions benefiting industrial, agricultural, livestock and fishing companies, any aid received will be cumulated (article 30.2 of the Regulation), taking the tax period into account, and the reduction resulting from applying this regime will be calculated.
- > In the case of RBI, article 30.3 of the Regulation establishes that the result of multiplying the tax rate by the amount of the reduction applied will be computed. For PIT payers, the proportional part of the reduction applied corresponding to the investments made will be computed.
- > The informative tax return corresponding to the previous calendar year must be submitted by the deadline established to file the corresponding CIT, NRIT or PIT self-assessment (article 32.1 of the Regulation). Given that the PIT filing period has already ended and that the CIT and NRIT filing period for payers with a permanent establishment is about to end for a large majority of companies, a **transitory provision** has been adopted (sole transitory provision of the Royal Decree), which provides that for tax periods starting on or after January 1, 2023 and ending before January 1, 2025, the deadline for filing the tax return will be 25 calendar days following the date of entry into force of the ministerial order unless the tax return form has been approved before the end of the ordinary filing period for the informative return. In other words, if the ministerial order is published shortly, as expected, there will be a period of 25 days from its publication to comply with the 2023 reporting obligation, with the 2024 data being reported within the ordinary period provided for in the Regulation.



For additional information, please contact our [*Knowledge and Innovation Group*](#) lawyers or your regular contact person at Cuatrecasas.

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