Spain

Spain

General

1. What are the recent tax developments in your country which are relevant for M&A deals?

A new Corporate Income Tax (CIT) act, which was approved on November 27, 2014 and entered into force on January, 1, 2015, has substantially modified the CIT regime previously in force. The main aspects being modified, which are analysed in greater depth in the sections below, are the following:

- The scope of the participation exemption on dividends and capital gains on transfers of shares, which was previously in force only for foreign subsidiaries, has been extended to domestic source dividends and capital gains. Likewise, the requirements to have access to the exemption have been modified.
- The tax treatment of capital gains obtained by EU corporate investors on the sale of Spanish subsidiaries has been amended in order to align it with the tax treatment of those obtained by Spanish resident corporations.
- The deductibility for tax purposes of merger goodwill disappears as a mechanism for avoiding double taxation and the requirements for amortization of goodwill acquired following an asset deal become more flexible.
- The rules regarding the deductibility of financial expenses have been modified, restricting the effectiveness of traditional structures which were implemented to finance acquisitions and push-down the debt.
- NOLs can be carried forward in future years without a time restriction, but the taxable base that can be offset yearly against NOLs has been limited. Likewise, the anti-NOL trafficking rule has been modified.

Specific CIT legislation is applicable in the Basque Autonomous Community, which has autonomous legislative powers in tax matters. Companies subject to Basque autonomous regulations may benefit of significant tax advantages: dividends received and capital gains on transfers of participations are generally exempt, while impairments on the participations can be deducted; financial expenses are fully deductible (subject only to the thin capitalisation rules); goodwill embedded in the acquisition price of the participations may be deducted; losses of foreign permanent establishments may be deducted, while the income is exempt. The main specialties of Basque tax regulations are explained below.

2. What is the general approach of your jurisdiction regarding the implementation of OECD BEPS actions (action Plan 6 specifically) and, if applicable, the amendments to the EU Parent-Subsidiary Directive?

Spain has partially adapted the CIT regulations to some of the measures proposed under some of the OECD BEPS action plans (as specifically remarked in the preamble to the new CIT Act) and Spanish regulations set forth a wide range of anti-abuse rules which are in line with the principles stemming from the OECD BEPS works, among others:

- An anti-abuse rule regarding hybrid instruments which limits the deductibility of expenses with related companies which, as a result of a different tax classification at the level thereof, do not generate income or generate exempt income or income subject to a tax rate of less than 10%
- A limitation to the access to the participation exemption regime of hybrid instruments has been introduced, by which the participation exemption does not apply when dividends distributed by a non-resident subsidiary generate a deductible expense at the level thereof.
- Specific restrictions are laid down as regards the tax treatment of some hybrid instruments (i.e. participating loans, return on certain types of equity instruments, among others).
- The Spanish CFC rules and transfer pricing rules were modified as well to adapt them to the OECD BEPS recommendations.

The above anti-abuse rules related have not been included in the Basque CIT regulations.

On the other hand, Spain does not have a model Double Tax Treaty (DTT) or a standard anti-abuse clause. However, it has generally tried to introduce anti-abuse rules in the DTTs that it signs -specially the most recent ones- and, where the old DTTs are renegotiated, anti-abuse clauses are in most cases included.

In regards to the amendments to the EU Parent-Subsidiary Directive, Spain already has an anti-abuse rule in place according to which the domestic exemption implementing the EU Parent-Subsidiary Directive does not apply if the parent company is located in a tax haven or if the majority of its voting rights are held, directly or indirectly, by an individual or legal entity not resident in the EU or a country in the European Economic Area with an effective exchange of information with Spain, unless the parent company has been established to operate on valid economic grounds and for substantive business reasons. The Spanish government will have to review whether the domestic anti-abuse clause is in line with the EU Parent-Subsidiary, but, in principle, its current wording is very similar to that of the general anti-abuse clause foreseen in the EU Parent-Subsidiary Directive.

3. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?

Asset deals

Under Spain's general tax law rules an acquirer party (the buyer) may be deemed to be jointly liable for pre-closing tax liabilities of a target business if the transfer is deemed to constitute a transfer of an on-going concern. In such a case the buyer may be deemed to be the successor of the seller in the business acquired. Consequently it is crucial to analyse in detail the nature of assets acquired in every due diligence process. If the assets acquired are standalone assets not deemed to constitute an on-going concern the pre-closing tax liabilities related to such transferred assets, in principle, will remain with the seller unless there is a contractual agreement specifically providing for the transfer of such liabilities to the buyer.

To limit potential tax liabilities derived from the asset acquisition the buyer may request from the Spanish tax authorities a certification in respect of the tax liabilities and pending penalties due by the seller. This certificate has a binding effect for the Spanish tax authorities and a tax audit could only demand payment for the amounts shown therein.

In a taxable asset acquisition the purchase price paid by the buyer allocated to each asset will be regarded as its tax basis. Such allocation is often a contentious issue for parties to the transaction, as the buyer and seller's interests in this respect may differ. The tax basis of the assets acquired should be stepped up to represent the assets' fair market value. This step-up may increase the amount of the future tax depreciation or amortisation deductions corresponding to the assets acquired. The portion of the purchase price not allocated to specific assets will be deemed to be attributable to goodwill in the case of acquisition of a business from an accounting point of view (see section 5 below for details of the goodwill deductibility). The target's existing tax attributes, such as Net Operating Losses (NOLs) however do not carry over to the buyer.

Asset sales may also be subject to Value Added Tax (VAT) at the applicable VAT rate (the general VAT rate is 21%). If what is being transferred is a going concern, VAT would not apply. If real estate property is transferred within the context of a going concern, the transfer would in principle be subject not to VAT but to Transfer Tax (TT) at a rate that would vary between 7%and 11% (depending on the Spanish region that would be entitled to tax the transfer).

However, if the real estate property is not transferred within the scope of a transfer of a going concern, the VAT exemption for real estate could be waived by the taxpayer provided certain conditions are met. As a consequence, and in accordance to the VAT act, the purchaser, in his condition of VAT taxpayer, must self-assess the relevant VAT quota. If the VAT exemption is waived, TT would not be levied and VAT would apply. In such case, the transaction will be subject to stamp duty at a rate that would vary between 0.5%and 2.5%.

From a buyer's perspective it is generally preferable to acquire business assets directly (to the extent the buyer can obtain a step-up in the assets' tax basis and could record amortisable goodwill – see section 5 below for further information). In Spain sellers, are generally not inclined to structure sales transactions as asset deals, as a seller might prefer to avoid the double layer of taxes (at the level of seller and its shareholders if they are not exempt) that could derive from an asset deal. However circumstances that might make the seller lean towards an asset deal include the existence of a pending offsetting of NOLs, or, from an economic perspective, when the seller can factor into the sale price the buyer's potential savings in connection with the step-up in tax basis of the assets transferred, among others.

Asset purchases may also give rise to relevant non-tax issues. For instance from a corporate law perspective an asset purchase may sometimes not be advisable where licenses, agreements and contracts might not be transferred (or renegotiated) without incurring additional costs or a cumbersome administrative procedure.

Share deals

In share deals the acquired entity (target) remains in existence, and any of its historical or contingent liabilities remain with it after the completion of the transaction. The target is entitled to carry over its tax attributes (such as NOLs or tax credits) as well.

In Spain NOLs can be carried forward with no time limit (the carry-back is not permitted). However, the right of the Spanish Tax Authorities to audit tax losses which have been off-set or are carried forward prescribes in 10 years, starting to count from the date after filing the CIT return corresponding to the fiscal year in which the tax loss was generated. Once the 10-year period is expired, the Spanish Tax Authorities are not entitled to audit the tax losses; nevertheless, the taxpayer must be capable of demonstrating the origin of the tax losses which it is willing to off-set with the exhibition of the tax return and accounting records.

In addition to the absence of a time limit for the offset of tax losses, the amount of taxable income in a year that may be offset by NOLs is limited to 70% (temporarily, to 60% in fiscal year 2016) of the tax base, and admitting, in all cases, the offset up to an amount of €1 million.

Under Basque CIT legislation NOLs can be carried forward for 15 years (for NOLs generated before 2014, this 15 year period starts on 1 January 2014), but they can offset 100% of the taxable income of any year.

With regard to NOLs, Spain's CIT rules provide for certain anti-NOL trafficking rules where all of the following circumstances occur:

- The majority of the share capital of the target is obtained by a person or entity or group of persons or entities after the end of the fiscal year in which the tax loss was generated.
- The persons/entities stated above (i.e. those taking control of the company) held less than 25% of the share capital in the company at the end of the fiscal year in which the tax loss was generated.
- The acquired entity falls under one of the following circumstances:
  - It had not been carrying out an economic activity in the 3 months prior to the acquisition;
  - It carries out an economic activity in the 2 years following the acquisition which is different from or additional to the one carried out before the acquisition, which implies a net revenue in the years following the acquisition which is 50% higher than the average net revenue obtained by the entity in the 2 years preceding the acquisition;
  - It is qualified as an instrumental entity; or
  - The entity has been de-registered from the tax entities' registry.

Under Basque CIT, anti-NOL trafficking rules only apply if the acquired entity has not carried out an economic activity in the six months prior to the acquisition.

Acquisitions of shares generally do not have immediate implications for the buyer. The basis in the target's underlying assets carries over and is not stepped up. Consequently it is not possible for the buyer to benefit from the additional tax amortization or depreciation of underlying assets. Nor can they benefit from the additional price paid that should be attributable to the goodwill of the business carried out by the entity whose shares the buyer acquires.

Under Basque tax regulations the buyer may benefit from an indirect deduction for the depreciation of goodwill or any latent gains existing in the target by means of the recognition of impairment in the value of the investment in the target or by means of a special deduction for the value of the target's goodwill embedded in the purchase price, as explained in section 4 below.

Finally the sale of shares of a Spanish company is not subject to any indirect tax, except TT (from 7%to 11%) if the purpose of the sale is to avoid the tax payable for the real estate properties owned by the companies whose shares are transferred.

Please note that it will be presumed that the purpose of the sale is to avoid tax in the following cases:

- When the transaction results in the buyer gaining control of an entity whose real estate assets located in Spain not destined to a particular economic activity are at least 50% of the total market value for all assets or, in the case that the buyer already has a controlling stake, when that stake is increased;
- When the transaction results in the buyer gaining control of an entity whose assets include a controlling stake in an entity with real estate assets which fit the previous description;
- When the shares received are the consequence of real estate contributed for the incorporation of entities or capital increases, if this real estate is not destined to an economic activity and three years have not elapsed between the date it was contributed and the transaction date.

The rules foreseen in the previous CIT Act which allowed for the step-up and deduction of merger goodwill have been abolished (see sections 4 and 5 below). However, the deduction of merger goodwill is still possible under Basque tax regulations.

4. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?

In principle there are no special provisions in the Spanish CIT law that provide a step-up in value of the target's underlying assets upon acquisition of its shares.

Under Basque regulations the acquirer may, subject to certain requirements and anti-abuse provisions, take an indirect deduction for the depreciation of any latent gains existing at in the target at the time of acquisition by means of the recognition of an impairment of such investment. A step-up of the assets may also be achieved through a merger, whereby the acquiring company absorbs the target after purchasing the target's shares (see section 5 below)

5. What are the particular rules of depreciation of goodwill in your country?

The CIT regulations state that goodwill acquired following an asset deal can be amortised for tax purposes over a period of 20 years (at a maximum 5% annual rate). This will not be applicable to the goodwill acquired prior to January, 1, 2015 from entities which form part of the same group of entities.

Under Basque regulations the maximum deductible depreciation rate for goodwill is 12.50%.

As mentioned, the new CIT Act foresees that the underlying goodwill embedded in the shares being acquired (i.e., the difference between the book value of the target and the purchase price paid for it that cannot be allocated to other assets and/or liabilities) cannot be amortised for tax purposes when a further merger between buyer and target takes place.

Under Basque regulations, subject to certain requirements and anti-abuse provisions, the buyer can deduct for tax purposes at a maximum 12.50% yearly rate the goodwill embedded in the acquisition price of the shares (without the need of absorbing the target). This deduction does not require an impairment to be booked. The acquiring entity may absorb the target and book this as a merger goodwill which can be deducted at a maximum yearly rate of 12.50%.

6. Are there any limitations to the deductibility of interest of borrowings?

From 2012 onwards, thin capitalisation rules previously in force were replaced by two new relevant measures:

Borrowing costs for the relevant fiscal year are not deductible if they relate to debts generated within the corporate group and incurred to acquire, from other entities in the same group, holdings in capital or equity of any type of entity, or to make contributions to capital or equity of other group entities. This restriction will not apply however (i.e., these borrowing costs will be deductible) if the taxpayer evidences the existence of valid economic reasons for performing these transactions.

Borrowing costs over and above a ceiling equal to 30% of the operating income for the period are not deductible. For these purposes:

- "Net borrowing costs" means the amount by which borrowing costs exceed the income derived from loans of company's funds to third parties in the tax period, not including, among others, any borrowing costs with group entities that are non-deductible under the rule related to borrowing costs described above.
- "Operating income" is obtained from the earnings from income statement operations for the year, determined by reference to the commercial code and other implementing accounting legislation, after:
- Subtracting the amortisation and depreciation expense for fixed and other noncurrent assets;
- Subtracting subsidies for nonfinancial fixed assets and others;
- Subtracting any impairment loss on, and gains or losses on disposals of, fixed and other noncurrent assets;Adding any financial income from investments in equity instruments.

This financial income only includes income from dividends or shares in income where either the taxpayer directly or indirectly holds at least 5%of the company concerned or the acquisition cost of the holding in the company was higher than €20m, unless the holding was acquired with funds borrowed from group entities and the related borrowing costs are not deductible.

This ceiling has been established subject to the following rules:

(I) Where the net borrowing costs for the tax period amount to €1m or less, they will be deductible in all cases;

(II) The portion that is not deducted in one period can be deducted in another period when operating income is higher or borrowing is lower.

Therefore:

- Any net borrowing costs that have not been deducted in one period may be deducted in the following periods, together with those for the period concerned and subject to an aggregate ceiling of 30% of the period's operating income;
- Where the period's net borrowing costs fall below the 30% ceiling that shortfall will be factored in to calculate the ceiling for tax periods ending in the five successive years immediately following.

It is expressly stated that the above ceiling will not apply to credit institutions and insurance companies. In the case of credit institutions and insurance companies that are taxed as part of a consolidated tax group jointly with other entities that are not, it is specified that the 30% ceiling must be calculated by reference to the operating income and net borrowing costs of those other entities.

Moreover, the CIT Law establishes the following rules that could have a bearing on the tax deductibility of borrowing costs:

- The transfer pricing rules, which limit deductibility of interest expenses when the conditions of the lending between related parties, is not arm's length.
- The non-deductibility of the return on equity, clarifying that this rule would apply to any securities representing the capital or equity of entities, regardless of their accounting treatment (e.g., non-voting shares or redeemable shares). Included in this category are participating loans granted by entities in the same group of companies (as group is defined in article 42 of the commercial code), the interest on which will not be tax deductible. This restriction on the deductibility of the remuneration of participating loans will not apply to contracts executed before June 20, 2014.

- The non-deductibility of expenses with related companies which, as a result of a different tax characterisation at the level thereof, do not generate income or generate exempt income or income subject to a tax rate of less than 10% at the recipient level (hybrid transactions).
- A specific restriction is laid down in cases of acquisitions of holdings in other entities if, thereafter, the acquired entity is included in the tax group of the acquirer or is merged with the acquirer, with a view to preventing the acquired activity from bearing the finance cost incurred on its acquisition. In this situation, borrowing costs related to the acquisition of these holdings over and above a ceiling equal to 30% of the operating income of the acquirer for the period are not deductible.

For these purposes:

- The restriction is limited in the case of a merger or an inclusion in a consolidated tax group taking place within 4 years following the purchase.
- It is possible to offset the finance costs that are not deductible for this reason in the following years (according to the general rules on deductibility of finance costs).
- This limitation on the deduction of finance costs will not apply if the debt incurred to finance the transaction does not exceed 70% of the acquisition cost of the shares and the debt is repaid at the rate of at least 5% annually for 8 years (until the debt reaches 30% of the acquisition price).

Under Basque regulations the above limitations to the deduction of interest do not apply. Instead a 3-to-1 thin capitalisation rule applies to net debt with non-related entities. A different ratio may be applied if the company's debt leverage is proved to be set at arm's length. No limitations apply if the net debt from related entities does not exceed EUR 10 million at any time in the tax year. Transfer pricing rules should also be considered.

7. What are usual strategies to push-down the debt on acquisitions?

The use of a Spanish special purpose vehicle (SPV) by a foreign buyer to carry out the acquisition of a Spanish target, coupled with the Spanish consolidated tax regime, has traditionally been a common way to push-down the indebtedness related to the acquisition of a Spanish target.

Streaming-up accumulated reserves and equity from affiliated companies to the SPV in exchange for debt, selling assets from the affiliated companies to the SPV, and merging the SPV with the target in a downstream merger were also strategies to consider for pushing down debt.

All these strategies have to be carefully analysed to ensure that they are not challenged on the basis of the general anti-abuse provisions, as well as to comply with the transfer pricing rules and, most significantly, with the requirements and limitations recently introduced regarding interest deductibility as set forth in section 6, which have substantially restricted the ability of companies to push down debt connected to acquisitions of equity interests by Spanish companies.

8. Are losses of the target company/ies available after an acquisition is made?

Generally the target's net operating losses at the date of the acquisition of its shares can be offset against the target's taxable income obtained in the same fiscal year or can be carried forward and used without a time limit (for 15 years under Basque tax regulations) considering the limitations described above in previous sections.

Spanish CIT law does not provide for a carry back rule. Conversely, it provides for change in control limitations (see section 3).

NOLs that could be deemed attributable to a business transferred following an asset sale are not transferred to the buyer (please see limitations on the application of NOLs as explained above in section 3).

9. Is there any indirect tax on transfer of shares (stamp duty, transfer tax etc)?

Please see section 3 above.

10. Are there any restrictions on the deductibility of acquisition costs?

There are no specific restrictions on the tax deductibility, for the purposes of the buyer's CIT, of acquisition costs, as long as these costs give rise to accounting expenses on their profit and loss account. This applies both in the context of share deals and of asset deals.

11. Can VAT (if applicable) be recovered on acquisition costs?

VAT borne on acquisition costs may be totally recovered when the company is entitled to offset 100% of the input VAT. Therefore, companies which do not fall within the scope of Spanish pro-rata rules (i.e. deductible proportional rules) which limit the right to offset input VAT will be able to fully recover VAT. The refund will be requested through the last VAT return filed for a natural year and the Spanish Tax Authorities have to carry out the refund within 6 months following the request or late payment interest will be accrued in favour of the taxpayer.

In order to recover VAT without waiting until the last return of the year, companies may opt for the (voluntary) monthly return regime if certain requirements are met. The Spanish Tax Authorities have to carry out the refund within 6 months following the request or late payment interest will be accrued in favour of the taxpayer (in practice, the term is reduced after the Spanish Tax Authorities approve the first refund).

12. Are there any particular issues to consider in the acquisition by foreign companies?

Where a foreign buyer acquires a Spanish target, the following aspects should be taken into account:

- Whether dividends and capital gains obtained by the foreign buyer in connection with the participation held in the target would be taxed in Spain;
- Whether the investment through a company that benefits from the Spanish holding company regime (the ETVE regime, or entidad de tenencia de valores extranjeros) would be more advantageous from a tax perspective (e.g. from the perspective of future repatriation of funds to a foreign shareholder);
- The financing of the acquisition;
- The tax incentives connected to the investment.

Dividend distributions made by a Spanish company to non-resident shareholders are generally subject to withholding tax at a 19% rate. However, this rate may be reduced in the following situations:

- Where the parent company is a resident of an EU jurisdiction (or EEA country with an effective exchange of information with Spain) no withholding tax applies if certain conditions are met (mainly, a participation over 5% held for more than one year). Spanish non-residents income tax law includes an anti-abuse clause regarding dividend exemption which states that the exemption is not applicable if the parent company is located in a tax haven or if the majority of its voting rights are held, directly or indirectly, by an individual or legal entity not resident in the EU or a country in an EEA country with an effective exchange of information with Spain, unless the parent company has been established to operate on valid economic grounds and for substantive business reasons.
- Where a tax treaty provides for a lower withholding tax rate, the treaty rate will be applicable;
- Where the Spanish company distributing the dividends is subject to Basque tax regulations and the earnings being distributed originated in dividends or capital gains from foreign subsidiaries benefitting of the participation exemption or from exempt income from permanent establishments abroad, such distributions are not subject to withholding tax (provided the shareholder is not resident in a tax haven).

The implications of the sale of shares in a Spanish company are described in more detail in section 15 below.

The ETVE regime provides that dividends and gains derived by non-resident shareholders from their participation in an ETVE that are ultimately related to tax-exempt reserves (due to the applicability of the participation exemption regime) are not subject to tax in Spain (provided the shareholder is not resident in a tax-haven jurisdiction). The part of the gain attributable to the underlying value of foreign subsidiaries qualifying for the participation exemption in excess of their book value (hidden reserves) is also not subject to tax in Spain.

The use of Spanish holding companies entitled to the ETVE regime is common among multinational groups as a way to hold investments in foreign jurisdictions that have advantageous tax treaties in force with Spain (e.g. Latin American jurisdictions) and to hold shares of Spanish operating subsidiaries. In this latter scenario, a Spanish holding company entitled to the ETVE regime and its Spanish operating subsidiaries could benefit from the group relief provided by the consolidated tax regime; if the holding company is leveraged, interest expenses incurred at the level of holding company could be offset against the taxable income obtained by the operating subsidiaries, bearing in mind the existing restrictions to deduct borrowing costs.

Several strategies are commonly used to leverage Spanish acquisitions. If a financing vehicle resident in an EU jurisdiction is used, it could benefit from the exemption from Spanish withholding taxes on interest payments (under Spanish domestic provisions, interest payments to EU lenders are tax-exempt). Careful attention must be paid to the substance of those vehicles and the business reasons behind their existence; otherwise the exemption could be challenged on the grounds of anti-abuse provisions.

In addition, Spanish law provides for a special regime for the issuance of preferred shares and debt securities by Spanish and EU SPVs (provided such an SPV is not deemed to be resident in tax-haven jurisdictions under Spanish tax law). The securities issued by the SPV must be publicly traded and both the SPV and its ultimate owner are subject to the strict ownership, legal and information reporting requirements. From a tax perspective this regime provides advantages for both the issuer (e.g. deductibility of interest, exemption from capital duty) and investors (i.e., exemption of interest paid to non-resident investors).

In this respect, it should be noted that the CIT Law establishes the non-deductibility of expenses with related companies which, as a result of a different tax classification at the level of those companies, do not generate income or generate exempt income or income subject to a tax rate of less than 10% (hybrid transactions).

Finally, Basque tax regulations allow for the deduction at a maximum 12.50% yearly rate of financial goodwill embedded in the acquisition price of the shares in the target, both in Spanish and non-resident companies. Accordingly, Basque holding companies are commonly used for the acquisition of the target.

13. Can the group reorganise after the acquisition in a tax neutral environment? What are the main caveats to consider?

The Spanish CIT law provides for a special tax neutral regime applicable to certain qualifying corporate restructurings (such as mergers, spin-offs, special contributions-in-kind, exchanges of shares representing a company's share capital, among others), based on the tax regime of the EU Merger Directive. Under Basque regulations this tax neutral regime may also apply to global transfers of assets and liabilities to shareholders owning 25% or more of the company's share capital.

This is configured like the standard regime for restructuring transactions and there is a general obligation to inform the tax authorities when transactions eligible for the regime are carried out. (In the case of companies subject to Basque tax regulations an election for the tax neutral regime is required.)

This regime provides for a tax neutral treatment for restructuring transactions (both from a CIT and indirect tax perspective), by providing that:

Capital gains or losses realised on the transferred assets are not included in the CIT taxable base of the transferor party;

- The acquiring entities receive a carryover basis in the assets acquired. The rules governing the qualification of a transaction for purposes of the mentioned regime are complex, and its applicability should be carefully analysed on a case-by-case basis.

The main caveat to consider for tax neutral restructurings under the Spanish tax regime based on the EU Merger Directive is the specific anti-abuse provision that requires the transaction to be carried out under valid economic purposes and not with the sole purpose of obtaining a tax advantage.

14. Is there any particular issue to consider in the case of companies whose main assets are real estate?

Capital gains obtained by non-residents in connection with transfers of shares of companies whose main assets are directly or indirectly real estate located in Spain are deemed to be subject to tax in Spain, at a 19% rate. The domestic exemption on capital gains on the sale of qualifying subsidiaries obtained by EU tax residents does not apply if the main assets of the subsidiary are, directly or indirectly, Spanish real estate properties. In cases where a tax treaty is applicable, its provisions must be analysed to determine whether such gain should be subject or exempted from Spanish taxes, though the vast majority of such treaties allow the source State to impose tax on those gains.

Capital gains obtained by resident entities in connection with transfers of Spanish companies whose main assets are real estate located in Spain are taxed in the same terms as capital gains on companies without real estate at the ordinary CIT rate (25% or 28% under Basque regulations). However, the capital gain may qualify for the participation exemption if the relevant requirements are met.

In either case, it is important to note that Spanish transfer tax (from 7% to 11%) may apply to transfers of shares in case that it was deemed that the transaction had the objective of avoiding the tax otherwise payable for the transfer of the real estate properties owned by the companies represented by the shares. Transfer tax applies even if the shares transferred are shares of a company that indirectly owns real estate in Spain. The far-reaching scope of transfer tax rules should be borne in mind as transactions involving upper-tier entities could trigger Spanish transfer tax.

Seller's side

15. How are capital gains taxed in your country? Is there any participation exemption regime available?

Share deals

Capital gains obtained by Spanish residents from sales of shares are generally subject to a 25% CIT rate (28% under Basque CIT rules). However, a participation exemption regime may apply. The new CIT Act unifies the treatment given to dividends and gains on holdings in Spanish resident and non-resident entities, by making the participation exemption regime available to both domestic and cross-border transactions, for which certain requirements must be met. To these regards, capital gains resulting from the sale of shares of a resident and non-resident company may benefit from the Spanish participation CIT exemption regime if the following requirements are met:

- The shares sold must represent at least 5% of the target's share capital, or if the minimum 5% stake is not held, the acquisition cost must be at least €20m and must have been acquired at least one year prior to the sale;
- If the target is a non-resident it must be subject to a tax similar to Spanish CIT with a tax rate of at least 10%. This requirement is deemed to be met if there is a tax treaty providing for an exchange of information clause in place between Spain and the target's country of residence;
- The exemption will not be applicable to capital gains obtained on the sale of stake held directly or indirectly in instrumental entities.
- The exemption will not be applicable to capital gains obtained on the sale of stake held directly or indirectly in entities which fall under the scope of the Spanish CFC rule and the said regime applies, at least, to 15% of their income.
- The exemption will not be applicable when the subsidiary is resident in a tax haven.

If the participation exemption regime is not applicable, the capital gain obtained is taxable in Spain and a tax credit (for the amount of taxes imposed abroad on such gain, if any) is granted. Fulfilment of the above requirements should be carefully analysed on a case-by-case basis since certain anti-abuse rules might be applicable.

Capital losses derived from the sale of shares can be offset against the ordinary income and capital gains obtained in the same fiscal year. Certain restrictions to deduct the loss may apply when the investment generated exempt income in the previous years or for intra-group transactions.

Taxable capital gains obtained by non-residents are taxed at a flat 19% rate. However an exemption might be available further to the provisions of a tax treaty or to domestic law. If the target is a holding company that benefits from the Spanish ETVE regime, the capital gain obtained by the seller derived from the sale of the target's shares might not be taxed in Spain, to the extent of the amount of the target's accumulated tax-exempt reserves (i.e., reserves that ultimately derive from tax-exempt dividends and capital gains obtained by the target as a consequence of the applicability of the Spanish participation exemption regime) and hidden reserves attributable to foreign subsidiaries of the ETVE.

Domestic law foresees that capital gains resulting from the transfer of movable property, obtained without a permanent establishment, by residents in an EU member state or by EU permanent establishments of residents in EU member states, will be tax exempt. This exemption will not apply to capital gains obtained in the transfer of shares when one of the following circumstances occurs:

- When the assets of the company consist principally, directly or indirectly, in real estate situated in Spain.
- For individuals, when in the 12 months prior to the transfer, the taxpayer held, directly or indirectly, at least 25% of the stake in the transferred entity.
- In the case of non-resident companies, when the requirements to apply the participation exemption regime for CIT purposes are not met.

Asset sales

If the seller is a Spanish resident company, capital gains derived from asset sales are generally subject to CIT at a 25% rate. Any potential capital gain can be offset against NOLs and other negative income, considering the limitations already described. Additionally, the capitalisation reserve can be applied (see section 19 below).

Under Basque regulations a full exemption of the gain is available subject to reinvestment of the sale proceeds. The general CIT rate is 28%.

If the seller is a non-resident company, capital gains obtained thereby in connection with the sale of assets located in the Spanish territory are generally subject to Spanish taxes, at a 19% rate. If the assets sold are attributable to a permanent establishment of the non-resident seller located in Spain, such a sale will be deemed to be a sale attributable to the permanent establishment and accordingly, it will be subject to Spanish CIT (at a 25% rate or 28% under Basque regulations).

The access to the domestic exemption for EU movable assets and the provisions of an applicable tax treaty may reduce the tax burden.

16. Is there any fiscal advantage if the proceeds from the sale are reinvested?

As a "replacement" for the traditional reinvestment tax credit, the CIT Law includes the so-called "capitalisation reserve" as an incentive for the reinvestment and capitalisation of companies.

Taxpayers subject to the standard tax rate can reduce their tax base by 10% of the increase in their equity provided that (i) this increase is maintained over a period of 5 years and (ii) a reserve is created for the amount of the reduction, duly separated and restricted (as non-distributable) over the 5-year period.

The reduction cannot exceed 10% of the positive tax base prior to the application of this reduction, the inclusion of adjustments for deferred tax assets and the offset of tax losses. If there is insufficient tax base, the outstanding amounts can be applied over the next 2 years, together with that of the year itself, subject to the same limit.

A number of rules are established for determining the increase in equity, mainly excluding shareholders' contributions or variations for deferred assets, which means that as a general rule the equity increase has to come from the year's undistributed income.

Under Basque tax regulations, reinvestment exemption applies to capital gains arising on the sale of tangible or intangible fixed assets used in the company's economic activities, where the full proceeds are reinvested in tangible or intangible fixed assets used for the company's economic activities or holdings of at least 5% in companies engaged in an active business operation. The reinvestment of the proceeds should be completed within 1 year before, or 3 years after, the transfer. The new assets should be held for at least 3 years (5 years for real estate), unless their useful life is shorter.

17. Are there any local substance requirements for holding/finance companies?

There are not specific substance requirements set forth for regular resident companies, but the access to the domestic participation exemption when investing in companies deemed as purely instrumental as well as certain tax benefits (for instance, benefits for small and medium entities) can be denied where an insufficient level of substance is deemed to exist. On the other hand, the ETVE regime will only be applied to holding companies whose activities (i.e. the management of the stake held in their subsidiaries) are carried out through an adequate organization of human and material means.

As regards non-resident companies, the benefits of a domestic exemption or an applicable DTT may be denied if the foreign company does not have sufficient substance to evidence its effective tax residence in the foreign jurisdiction or if, as a consequence thereof, the relevant structure was regarded as purely tax driven (i.e. merely aimed at benefitting from the relevant DTT or domestic tax advantages).

Your Taxand contact for further queries is:

Spain

Daniel Armesto
T. +34 944 700 699
E. daniel.armesto@garrigues.com

Albert Collado
T. +34 93 253 3700
E. albert.collado@garrigues.com

Francisco Lavandera
T. +34 93 253 3700
E. Francisco.Lavandera@garrigues.com