Tax Newsletter

GARRIGUES

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1. Self-assessments may be corrected outside the voluntary filing period to claim tax benefits

According to various courts, claiming or not claiming tax benefits is a right not an electable tax option, so taxpayers are allowed to correct their self-assessments even after the end of the filing period for the tax concerned.

Article 119.3 of the General Taxation Law (LGT) states that options which the tax legislation requires to be elected, requested or waived with the filing of a return may not later be modified, unless the correction is made in the voluntary filing period for the return for the tax concerned.

Based on that article, the tax authorities and the courts have found on a reiterated basis that, where an option is not elected within the filing period on a self-assessment, the taxpayer may not use the mechanism under article 120.3 LGT (unless they do so within the statutory period for filing the return). This article states that where a person with tax obligations considers that a self-assessment has had an adverse effect on their lawful interests they may apply for a correction of their self-assessment.

The flexibility with which the tax authorities and the courts are interpreting the concept of tax option has on repeated occasions led to taxpayers being denied their rights to offset tax loss carryforwards, or using other types of tax assets or incentives, where they have not made the election on self-assessments filed in the voluntary period (or have done so for an amount lower than the sum to which they were entitled).

The National Appellate Court concluded recently however that the decision to offset tax loss carryforwards or to do so in one amount or another may be modified after a corporate income tax return has been filed; and affirmed, among other things, that article 119.3 LGT relates to returns not to self-assessments. The December 11, 2020 judgment was discussed in our alert dated January 15, 2021 (here).

Other courts have been making the same findings. The Basque Country High Court, for example, did so in its judgment of October 19, 2020. The facts examined in this judgment concerned an entity that had not claimed a number of tax credits on its corporate income tax self-assessment, by mistake, despite satisfying the requirements in the legislation for these credits. It therefore applied for a correction of its self-assessment.

The court concluded that a failure, by mistake, to claim benefits is not a tax option and cannot be interpreted as a decision not to claim them, in that it is a right belonging to the person with tax obligations. As a result, there is no legal impediment preventing the taxpayer from using the self-assessment correction procedure to claim the benefits to which they are entitled.

2. Judgments

2.1 Freedom of establishment.- EU law precludes national legislation that does not allow a company in a member state to deduct interest payments made to a related company in another member state, on the basis of a tax benefit that would not have been assessed if both companies had been established in the first state

Court of Justice of the European Union. Judgment of January 20, 2021. Case C-484/19

A Swedish company requested a loan from a French company in its group to purchase shares in a subsidiary from another Spanish entity in the same group. The interest recorded as payments by the Swedish company to the French entity were used to offset tax losses.

In Sweden, the Swedish company was denied the right to deduct the interest payments on the loan, by relying on the exception. Briefly, the Swedish tax authorities considered that the transaction had been performed to create deductible expenses in Sweden, where the conditions for deducting interest payments were more favorable than in Spain.

The referring court asked the CJEU whether it is compatible with the freedom of establishment for the national legislation in Sweden to refuse to allow a Swedish company to deduct the interest paid to a related company established in another member state, on the ground that the main reason for acquiring the debt is for the group to obtain a substantial tax benefit, when that tax benefit would not have been deemed to exist if both companies had been Swedish is compatible.

The CJEU concluded that legislation such as that described is contrary to the freedom of establishment, in that it contains difference in treatment in comparable situations, for which no justification could be found, based on a balanced allocation of the power to impose taxes between the member states or the fight against tax evasion.

2.2 Corporate income tax.- To be able to claim the special finance lease regime the leasing activity does not need to be classed as an economic activity for personal income tax purposes

Supreme Court. Judgment of December 1, 2020 and judgment of December 17, 2020, in appeals 2310/2019 and 1773/2019

Article 115 of the revised Corporate Income Tax Law, approved by Legislative Royal Decree 4/2004 (TRLIS) contained a special tax regime for certain types of finance lease agreements, under which, within certain limits, the finance cost and installments relating to the cost of the leased item paid to the lessor were treated as tax deductible expenses.

Based on that article, the appellant (which leased out various sets of premises acquired under a finance lease agreement) made a negative adjustment on its corporate income tax self-assessment which was rejected by the tax authorities because, in their opinion, property leasing was not classed as an economic activity under the personal income tax legislation.

The Supreme Court concluded in these judgments that article 115 TRLIS did not require, in the examined years, the items under the finance lease to be used in an economic activity, and it allowed the special tax regime to be claimed in the examined case.

2.3 Corporate income tax.- A sham transaction exists in the services provided by an individual through a company where that company's intermediation is unnecessary

Supreme Court. Judgment of December 11, 2020 and judgment of December 17, 2020, in appeals 872/2019 and 5977/2018

The facts of the case examined in these judgments were as follows:

(a) Company A is practically wholly owned by an individual who is also director and authorized signatory for the bank accounts of company B.

(b) Company A's income consists almost entirely of revenues from entity B.

(c) Company A only has two salaried workers. One of these individuals does not work full time and the other has their registered address in a different place to where the company has its registered office and does not have the required qualifications for the activity.

After determining that it is the shareholder individual that actually provides services to B, the Supreme Court concluded that it is completely unnecessary for the individual to use a professional firm (A) to bill the client (B). Therefore, the court concluded that, based on the examined facts, a sham arrangement must be held to exist.

The court recalled that a decision cannot be rendered on all cases of professional companies in the abstract nor can a general theory established as to when the activities of those companies fall within the parameters of what is known as "tax planning" and when, to the contrary, these companies may become tools to evade taxes, therefore a case-by-case analysis is needed.

2.4 Personal income tax.- The provision of services to a company after the employment relationship has ended does not automatically mean that there has not been an actual severing of ties

Galicia High Court. Judgment of September 17, 2020

The Personal Income Tax Regulations provide as a condition for claiming the relief for dismissal or termination of employment that an actual severing of ties with the worker must occur. It is presumed that ties have not been severed if an individual person provides services to the company again within three years following termination of their employment contract.

In the examined case, the dismissed worker was rehired within three years after termination of their employment. The tax auditors considered that a severing of ties had not taken place and disallowed the relief.

The Galician High Court concluded that:

(a) To fulfill the purpose of the law, the facts for each case need to be examined to conclude whether the worker actually severed ties with the company when the employment contract was terminated. It must be remembered that this is a rebuttable presumption.

(b) In the examined case, the severing of ties must be considered proven because the termination took place as part of a collective layoff and in the subsequent hiring no length of service was recognized nor were any vested rights carried over from the previous employer/employee relationship.

2.5 Nonresident income tax.- Taxation in Spain of dividends received by pension funds resident in third countries violates EU law

Supreme Court. Judgments of December 17, 2020 and of December 22, 2020, in appeals 5081/2018, 6746/2018 and 6035/2018

Article 63 of the Treaty on the Functioning of the European Union (TFEU) prohibits restrictions on the free movement of capital. In the tax field this prohibition prevents the member states from establishing different treatment in the taxation of domestic taxpayers and their counterparts resident in other states (including countries outside the EU), whenever their situations are objectively comparable (on this subject, see for example supreme court judgment 1581/2019, of November 13, 2019, regarding US investment funds).

In these new judgments, the Supreme Court examined cases of Canadian pension funds that received dividends from Spanish listed entities on which 15% tax was withheld, under the Canada-Spain tax treaty in force in the years concerned (2007, 2008 and 2009). Whereas under domestic law resident pension funds were taxed at 0%.

In this context, the Supreme Court held that:

(a) Different treatment based exclusively on residence occurs.

It is irrelevant whether the Canadian fund satisfies the conditions laid down in Spanish law for Spanish pension funds (as the authorities claimed), because it is the law itself that establishes the difference in treatment, without making the taxation of nonresidents depend on the satisfaction of any condition or establishing a probative source for substantiating that situations are comparable.

In other words, the justification for the different tax treatment does not have to be sought in the specific situation of every nonresident taxpayer, instead it should be contained in domestic law itself. For that domestic law not to run counter to the free movement of capital, it is required therefore for it to set out the existence of mechanisms for avoiding the prohibited restrictions, without the need to use refund procedures outside the specific rules on the taxation of income.

(b) The exchange of information mechanisms defined in article 26 of the tax treaty are sufficient to enable the Spanish tax authorities to determine the equivalence of Canadian pension funds to domestic pension funds, under the provisions in the Revised Pensions Plans and Funds Law. The Supreme Court arrived at this

conclusion because the tax treaty follows the OECD model tax treaty, which in its commentaries sets out that necessary information must include any information that the requesting authorities consider necessary or relevant.

In view of this, the Supreme Court concluded that a restriction exists that runs counter to the TFEU, and for that reason, foreign funds are entitled to a refund of taxes paid in excess.

2.6 Inheritance and gift tax.- For donations made by bank transfer, the right to assess becomes statute bared four years after the end of the filing period

Supreme Court. **Judgment of November 30, 2020**

Under article 48.2 of the Inheritance and Gift Tax Regulations, for donations recorded in private documents, the statute of limitations starts to run from the date of their registration at a public registry, from the death of any of the signatories, or from the date on which it is delivered to a public official by reason of their position (as read in conjunction with article 1,227 of the Civil Code).

According to the Supreme Court, the aim of that article is to prevent the opaqueness inherent in all private documents hindering the tax authorities from acting and assisting tax evasion. However, this involves using regulations to alter the general regime set out in the General Taxation Law, which links the start of the statute of limitations for the tax with the due date of the tax and the end of the filing period for the return or self-assessment by making it start on that due date.

Therefore, the statute of limitations for assessing the tax obligation arising from donations substantiated by bank transfers, which only appear in the records of the bank concerned, starts to run on the day following the end of 30 business days following the date those transfers were made (in other words, as a general rule, the date following the end of the filing period for the inheritance and gift tax return in the case of donations).

2.7 VAT.- Making vehicles available to employees in exchange for no payment or without the employees giving up part of their salaries or other benefits is not a transaction for consideration

Court of Justice of the European Union. Judgment of January 20, 2021. **Case C-288/19**

The court examined the making available of company vehicles to employees where in exchange for the use of the vehicle the employee does not have to make any payment to the company, or give up any part of their cash compensation (as happens in flexible compensation systems); and the choice of a vehicle does not mean that the employee has to give up other benefits. Namely, it was examined whether in these cases it may be considered that there is a hiring of a means of transport to non-taxable persons and therefore whether the place-of-supply rule in article 56(2) of the VAT Directive applies (which determines that the place of hiring is where the customer is established).

The court concluded that in these cases there is not a supply of services for consideration. More exactly, according to the court, a supply of services is only made for consideration if there is a legal relationship between the provider of the service and the recipient pursuant

to which there is reciprocal performance and the remuneration received by the provider of the service constitutes value actually given in return for the service supplied. In the case of workers, the most common scenario is a flexible compensation system in which they give up part of their cash compensation in return for the service provided by the employer (in this case, the making available of a vehicle).

Therefore, in the examined case that place-of-supply rule for services does not apply because the service (making available of a vehicle) has to be supplied for consideration and for a period longer than 30 days.

2.8 VAT.- The price of hidden sale transactions that have not been invoiced is "VAT inclusive"

Supreme Court. Judgments of December 17, 2020 (cassation appeals numbers 1373/2019 and 1954/2019)

Article 78.one of the VAT Law states that the taxable amount is made up of the entire consideration for transactions subject to VAT from the customer or from third parties. At issue in these judgments was whether, where the tax auditors identify hidden transactions that have not been invoiced, the price agreed between the parties must be considered to include VAT.

To settle this question, the Supreme Court interpreted the case law of the CJEU (judgment of November 7, 2013 -Tulica and Plavosin, joined cases C-249/12 and C-250/12-), according to which the prices of hidden transactions must be taken to include VAT if the following tests are met: (i) the parties must establish the price without any reference to VAT, (ii) the seller must be the taxable person for the VAT, and (iii) the seller must not be able to recover from the purchaser the VAT claimed by the tax authorities.

The Supreme Court remarked in this respect that, where in a contract no reference is made to VAT, treating the whole of the price agreed between the parties as the taxable amount would (if domestic law does not allow the seller to recover from the purchaser the VAT claimed by the tax authorities) result in the VAT being charged to the seller, which goes against the principle holding that consumption taxes must be paid by the end consumer. That approach also goes against the rule that the tax authorities cannot receive in respect of VAT a higher amount than the sum obtained by the taxable person.

2.9 VAT.- Exemption for granting credit and transactions concerning other negotiable instruments applies to transactions in which one taxable person makes available to another funds obtained from a factoring company, guaranteeing repayment on maturity in exchange for remuneration

Court of Justice of the European Union. Judgment of December 17, 2020. Case C-801/19

In this judgment the court examined a transaction in which a lender that was not a banking or financial institution transferred to a factoring company bills of exchange issued by a third party. The funds obtained from the factoring company were delivered to this third party. The lender received a fee for this transaction and gave an undertaking to the factoring company to repay the advance funding. The issue examined by the court was whether that

transaction was eligible for the VAT exemption for "granting and negotiating credit" and for transactions concerning "other negotiable instruments", allowed, respectively, in letters b) and d) of article 135.1 of the VAT Directive.

The court replied that it was.

(a) It first underlined that the exemption for "granting and negotiating credit" must be interpreted broadly to the effect that it does not depend on the person providing or receiving the services, the agreed form of consideration, or who undertakes to repay the funds to the person who provided them.

(b) In relation to the exemption for transactions concerning "other negotiable instruments", which according to the court must include the bills of exchange, the issue stemmed from the Croatian government's view that the lender's activities constituted a debt collection service, which is expressly excluded from the exemption.

The court held, however, that the lender had not carried out a debt collection transaction or acted as intermediary for the factoring company. Instead, insofar as the provision of funds was intrinsically linked to the issue of bills of exchange and the lender was a party to the contracts relating to the bills of exchange, the provision of that service may be regarded as a distinct whole which has the effect of fulfilling the specific and essential functions of the transaction concerning the bills of exchange.

2.10 VAT.- The infringement caused by VAT charged incorrectly on the invoice by someone other than the taxable person, where the tax is not paid over to the finance authority, does not arise where the charge is made on other types of documents

Supreme Court. Judgment of November 26, 2020

Article 170.two.3 of the VAT Law states that VAT charged incorrectly on an invoice by someone other than the taxable person and not paid over to the finance authority is a tax infringement. In this judgment it was examined whether this infringement includes VAT charged incorrectly on a document other than the invoice (a public deed, for example) and arises simply due to the tax not being paid over to the tax authorities.

The Supreme Court held that the principles of legality and definition, as well as the prohibition of analogy *in malam partem*, impose a strict interpretation of that article.

Briefly, the requirements for the infringement to exist are that: (i) VAT must have been charged incorrectly, (ii) the person who made the charge must have been someone other than the taxable person, (iii) the tax must not have been paid over, and (iv) the tax must have been charged on an invoice, not on any other type of document.

2.11 Transfer and stamp tax.- Termination of a condominium on an indivisible asset is subject to stamp tax not transfer tax (as a transfer for consideration), even if co-ownership of other assets remains unchanged

Supreme Court. Judgment of December 17, 2020. **Valencia Regional Economic-Administrative Tribunal.** Decision of February 28, 2020

The Supreme Court examined a case involving two brothers who inherited a number of properties. They later terminated the condominium on one of the properties (an indivisible asset) and transferred ownership to one of the brothers, who paid the other brother an amount equal to half of the property. The other properties continued to be owned by both in indeterminate shares.

The court held that this was a termination of the condominium on an indivisible asset. Therefore, even though they retained co-ownership in relation to other assets (which the court referred to as "partial termination of subject matter"), the transaction did not become subject to transfer tax as a transfer for consideration, because there was no intention to transfer ownership of any of the buildings, only to terminate co-ownership status. Since it was not subject to transfer tax, the transaction will be subject to stamp tax if the requirements are met.

As the court explained, this case differs from another it had examined earlier in a judgment delivered on June 26, 2019, concerning a condominium among four co-owners where two of them transferred their shares to the other two (married under a separate property arrangement), in return for a cash payment. In this case, the court considered that termination had only taken place with respect to the parties (because the number of owners had been reduced but the condominium continued to exist), and therefore it became subject to transfer tax as a transfer for consideration.

This second scenario was examined by Valencia TEAR (in a decision rendered on February 28, 2020), with the particular characteristic that the individuals retaining co-ownership were married under a joint property arrangement. For that reason, the tribunal considered that the transaction did not become subject to transfer tax as a transfer for consideration, because termination of the condominium was carried out to become part of the marital community property (which is treated as a single owner).

2.12 Transfer and stamp tax.- Tax authorities have burden of proving that a property's reported value does not match its actual value

Andalusia High Court. Judgment of December 3, 2020

The tax authorities considered that the value of a property reported by a taxpayer for transfer tax purposes (as a transfer for consideration) was not its actual value and replaced it with the value that had been given in an appraisal report prepared for the mortgage.

Andalusia High Court, in line with the case law of other high courts, concluded that data reported by taxpayers are presumed valid, and therefore the tax authorities must give reasons and provide support for their decision not to accept the reported value. Moreover,

according to the court, the actual or market value of an asset, which is the taxable amount for transfer tax purposes as a transfer for consideration, should not be confused with the value given in an appraisal report for a mortgage.

Therefore, if the tax authorities consider that the appraised value for the mortgage is the market value of the property they have to give reasons and provide support for this view, which did not occur in the examined case.

2.13 Transfer and stamp tax.- Recording of a transaction with a condition precedent is subject to stamp tax

Andalusia High Court. Judgment of October 27, 2020

In the examined case, a public deed was executed recording the transfer of an asset. The validity of the transaction was made subject to a condition precedent. For that reason the taxable person considered that it did not become subject to stamp tax until the condition precedent was satisfied.

Andalusia High Court, however, accepted the tax authorities' arguments and concluded that the taxable event for stamp tax purposes occurs simply as a result of execution of the document not of its validity. Therefore, the tax fell due when the public deed for the sale was executed, and the condition precedent for the transaction recorded in it is irrelevant.

If, by contrast, the transaction had been subject to transfer tax as a transfer for consideration, the tax would not have fallen due until the condition had been satisfied.

2.14 Collection procedure.- The tax authorities incorrectly allowing deferred payment cannot have an adverse effect for the taxpayer

Supreme Court. Judgment of December 14, 2020

Article 188 of the General Taxation Law states that penalties can be reduced by 25% if they are paid within the payment period or on the terms provided in the relevant deferred or split payment decision, and a guarantee or surety bond certificate is provided.

In the case examined in this judgment, the taxpayer had applied for deferred payment of a penalty providing a unilateral chattel mortgage as security, because two financial institutions had refused to provide bank guarantees. The deferred payment related to the penalty less the 25% reduction and, although the tax authorities made a request for the taxpayer to correct certain defects in the application, they ultimately allowed deferred payment of the reduced penalty.

Later, however, the tax authorities claimed payment of the penalty without the reduction because the provided security was not of the required type.

The Supreme Court acknowledged that according to the letter of that article 188 the reduction is only applicable where the penalty is secured with a guarantee or surety bond certificate. In view of the particular circumstances of the case however, the court accepted the taxpayer's arguments because it considered that the tax authorities had given the appearance of allowing the reduction, even though the security that had been provided differed from those specified. If the tax authorities did not want to allow the reduction, they

should have made a request to the taxpayer to increase the amount of the security to cover the aggregate amount of the penalty without the reduction. Because they had not done so, the taxpayer believed everything to be correct, so the principles of good faith and legitimate expectations bar the authorities from claiming the amount of the reduction.

2.15 Collection procedure.- Filing supplementary returns to apply principles explained verbally by tax auditors before issuing assessments does not bar surcharges

Supreme Court. Judgment of November 23, 2020

During a 2012 VAT audit, the audit team gave out information on a number of principles that could give rise to an adjustment. For that reason, before the audit had finished, the taxable person filed supplementary returns for later periods, to adapt their tax position consistently with the information the auditors had been giving out. The 2012 VAT audit ended with an assessment report signed with agreement in which the taxable person's position was adjusted in line with the explanations they had given.

The tax authorities imposed surcharges for the late filing of supplementary returns. These surcharges are payable where the taxable person adjusts their position voluntarily without a prior request from the tax authorities.

The Supreme Court looked into the concept of "prior request" and concluded that it must be interpreted broadly, to the effect that, if the late filing of a self-assessment is due to becoming aware of relevant facts contained in an assessment report with agreement, no surcharge is payable.

In the examined case, however, the supplementary self-assessments were filed before the assessment report with agreement was signed and therefore in this specific case the court held that the adjustment was voluntary (in other words, not induced by a "prior request") and confirmed the surcharges imposed on the taxpayer.

2.16 Tax-related liability.- Payment by one jointly and severally liable party releases the others

Supreme Court. Judgment of December 10, 2020

In this case joint and several liability for a tax debt had been determined for the parties who were considered to have caused or assisted with the concealment or transfer of the main debtor's assets or rights for the purpose of obstructing the action of the tax authorities (article 42.2 a) of the General Taxation Law).

The Supreme Court confirmed that liability for tax goes beyond the main debt, late-payment interest and penalties payable by the person with tax obligations to include also the enforced collection surcharge imposed on that person due to not paying the debt within the time limit. Moreover, on that aggregate debt a second enforced collection surcharge may be imposed, if the persons held jointly and severally liable do not pay within the time limit.

In relation to another issue, the court concluded that this is a single debt, which cannot be multiplied, so the payment of the surcharge imposed on the jointly and severally liable parties by any of them releases the others.

2.17 Tax-related liability.- Contractor or subcontractor's liability is restricted to debts related to services provided by the subcontracted entity

Supreme Court. [Judgment of December 3, 2020]

Article 43.1.f) of the General Taxation Law states that anyone hiring contractors or subcontractors for the performance of work or provision of services relating to their primary economic activity is secondarily liable for tax-related obligations in respect of taxes that must be charged or of withholdings "in the part relating to the work or services for which the contractor or subcontractor was hired".

Based on this article, a company was held secondarily liable for the tax debts (VAT for 2006 and 2007) of the subcontractor company hired to clean its premises.

The company that was held liable questioned the scope of the liability (in other words, the scope of the phase "in the part relating to the work or services for which the contractor or subcontractor was hired") because it considered that the debts for which liability had been shifted to it bore no relation to the services provided by the main debtor.

The Supreme Court accepted the appellant's arguments and clarified that, of the whole amount of the debt relating to the main debtor, the contractor or subcontractor can only be held liable for the part of that debt that was incurred in the work or services for which the contractor or subcontractor was hired. It clarified also that the burden of proving that the tax debts are related to the services for which the contractor or subcontractor was hired lies with the tax authorities and that liability cannot be presumed on the basis of failure to file the certificate on the absence of debts for the hired subcontractor.

2.18 Management procedure.- Where an assessment is voided due to procedural defects, reversion of procedure does not have to be ordered explicitly if the intention to do so may be inferred from tribunal's decision

Supreme Court. [Judgment of December 17, 2020]

Where an economic-administrative tribunal (totally or partially) voids an assessment issued in a management procedure, the tax authorities can issue a new assessment to replace the earlier one if their right to assess the tax debt has not become statute-barred.

The time period that the tax authorities are given to issue this second assessment in a management procedure depends on whether the economic-administrative tribunal holds that the procedure must be reverted to correct the formal defect found in the original procedure, or whether it voids the assessment on other substantive grounds.

In this judgment the Supreme Court clarified that in a reversion of procedure scenario, it is not necessary for it to be expressly ordered by the tribunal. The actual contents of the voiding decision must be taken into account to assess whether it required the tax authority to issue a new assessment, according to the parameters determined in the decision itself (rendering the assessment void on substantive grounds), or whether it lays down that, before issuing a new assessment replacing the earlier one, new work must be performed to correct the defect found in the original procedure (rendering the assessment void on procedural grounds).

If an express or implicit order to revert the procedure is found in the voiding decision, the time period for issuing the second assessment will be the time remaining in the original procedure from the point to which the procedure was reverted.

3. Decisions

3.1 Corporate income tax.- Deductibility of remuneration as a result of audit work on the recipient must be reported via an "accounting error"

Murcia Regional Economic-Administrative Tribunal. Decision of February 27, 2020

A company paid in 2012 its director's social security contributions, but did not treat them as a deductible expense.

In a review of the director's position on their 2012 personal income tax return, it was considered that he should have computed on his return compensation in kind in respect of the contributions paid by the company. The assessment resulting from this review took place in 2017. As a result of that assessment, the company applied for correction of its 2012 corporate income tax self-assessment to compute that item as a deductible expense.

The tax authorities rejected its application for correction because they considered that, under accounting legislation, the company's correction of the error by the company should have been done in the financial statements for the period in which the error was detected (2017).

Valencia TEAR confirmed this conclusion. The tribunal noted that, where an error is identified in the recording of a transaction in the accounts, the resulting prior year's revenue or expense must give rise to the recording in the period in which it was identified of an adjustment in respect of the cumulative effect of variations in assets and liabilities, which must be recognized directly in net equity (in a reserves account).

The greater expense arising from that adjustment, even though it is not recorded in the income statement, must be included in the tax base, by reducing it, through a tax adjustment in the period in which the error was corrected for accounting purposes, as long as the limits imposed by article 19.3 TRLIS (now article 11.3) are not exceeded, in other words, as long as it does not give rise to lower tax than would have been due under the standard timing of recognition rules.

3.2 Personal income tax.- Late-payment interest arising from adjustment in respect of a supervening breach of requirements for RIC reserve does not give rise to new late-payment interest

Central Economic-Administrative Tribunal. Decision of June 29, 2020

In a tax audit, the tax authorities adjusted the position of a personal income taxpayer due to a supervening breach of requirements in relation to the Canary Islands investment reserve (RIC). The tax auditors considered that the taxpayer should have included on its self-assessment for the period in which the breach occurred, both the amount of tax it had not paid by claiming the RIC incentive and late-payment interest calculated from the period in

which the incentive had been claimed until the period in which it had forfeited the right to that incentive. Moreover, on that interest the tax authorities charged new interest for the period until the date on which they made their assessment.

In this decision TEAC found against the requirement to pay this second type of interest, because there is no legal article supporting the compounding of late-payment interest (known as anatocism) in this case.

3.3 Nonresident income tax.- Reductions allowed in Personal Income Tax Law for residential rental income do not apply for same types of income obtained by nonresidents

Central Economic-Administrative Tribunal. Decision of November 24, 2020

The Nonresident Income Tax Law has to be read in conjunction with the Personal Income Tax Law in relation to determining the taxable income of taxpayers who are individuals. However, the Nonresident Income Tax Law states that nonresident income taxpayers cannot claim the reductions allowed in the Personal Income Tax Law.

An individual resident in Germany reported residential rental income, without claiming the 60% reduction allowed in the Personal Income Tax Law for these types of leases. Believing that the reduction could also be claimed by nonresident income taxpayers, despite the provision in the Nonresident Income Tax Law, the taxpayer applied for correction of their self-assessment and for a refund of incorrectly paid tax.

TEAC held that the reduction did not apply. In this regard, it affirmed that:

(a) There is no CJEU judgment that implies a derogation or amendment of the domestic legislation in this respect.

(b) Despite the existence of a letter of formal notice from the European Commission to Spain for it to remove the discriminatory treatment of nonresidents in relation to residential rental income, no reasoned opinion has yet been issued in the infringement procedure under EU law.

Therefore, it continues to be necessary to apply domestic legislation and in this case conclude that reductions cannot be claimed.

3.4 VAT.- Eligibility for reduced rate allowed for renovations of residential properties is determined by reference to predominant use of the building

Central Economic-Administrative Tribunal. Decision of October 21, 2020

The tax auditors considered that the work performed by an entity for partial renovation of a building owned by a religious congregation (used as a school, church and residence for religious workers) was taxable at the 21%, standard rate instead of the 10% reduced rate. The entity corrected its VAT charge by increasing it, but that charge was challenged by the religious congregation.

TEAC examined the requirements to charge the reduced rate on transactions for renovation of residential properties (as defined in article 91.One.3 of the VAT law) and, in particular, the need for at least 50% of the renovated buildings to be for residential use.

The tribunal affirmed that the areas used as residences (which must include the communal areas with exclusive use for the residential properties) must be compared with the gross building area. In the examined case, the court concluded that:

(a) The church, due to its physical location (clearly separable from the rest of the building) and due to the nature of its purpose, is used for the vocation or service of pastoral and evangelical activities targeted at a group of people that includes, at least, the pupils at the school, and therefore cannot be considered to be used as a residence.

(b) It is not possible to treat as separate services the work relating to residential properties within the work performed on the church and the school. In fact, if it were possible to divide the performance of complex projects carried out on multiple use buildings, the requirement for residential use to be at least 50% would lose its purpose.

(c) It is a different matter whether, in relation to the portion used for a residence, the congregation does not act in principle as trader or professional, and therefore under article 89. Three.1 of the VAT Law the charges would not have to be increased.

Nor is that correction needed in relation to any renovation transactions on the church and the school that fell due after October 31, 2012, because the congregations acted in relation to them as trader or professional and the reverse-charge mechanism under article 84.One.2.f) of the VAT Law would have been fully applicable. This does not preclude the congregation's obligation to report the VAT charged due to the modification to increase it.

3.5 Inheritance and gift tax.- In inheritances organized as an Aragonese executorship, no prepayment self-assessments are required on the death of the decedent

Central Economic-Administrative Tribunal. Decision of November 27, 2020

In a judgment delivered on January 31, 2012, the Supreme Court overturned article 54.8 of Royal Decree 1629/1991, of November 8, 1991 (containing the Inheritance and Gift Tax Regulations). Under that article, in inheritances to be performed under the Aragonese executorship system, the expected heirs had to make a provisional self-assessment on the death of the decedent. In its judgment the court reproached the article for allowing inheritance and gift tax to be assessed for individuals who did not know whether they would actually inherit, which was not acceptable.

Law 10/2012, of December 27, 2012, on tax and administrative measures in Aragon, amended Legislative Decree 1/2005, of September 26, 2005 (revised decree in Aragon on devolved taxes), and replaced, starting on January 1, 2013, the making of a provisional self-assessment on the death of the decedent with the making of a prepayment self-assessment at that same time. Law 15/2018, of November 22, 2018, on the taxation of an Aragonese executorship for inheritance and gift tax purposes, ultimately eliminated that prepayment self-assessment, by ordering a self-assessment to be made when the executorship is performed, which came into effect on December 14, 2018.

This TEAC decision examined the case of an inheritance under the Aragonese executorship system in which both spouses had granted to each other, in a joint will, the power for the survivor to distribute their assets and those of the predeceased among their descendants. In 2013 one of the spouses died, but the surviving spouse did not take on the duties of executor at that time. The descendants, as expected heirs, did not file the prepayment self-assessments required by Aragonese law. In a limited review procedure the tax authorities claimed that prepayment.

In a decision rendered on November 27, 2020, TEAC concluded against the prepayment under Law 10/2012, with the following reasoning:

a) The Aragonese regional legislation must be interpreted in a way that is compatible with the distribution of powers between the central and regional governments.

b) Its (i.e. TEAC's) obligation to apply the legislation in force in light of the case law (and without questioning the constitutionality or validity of Aragonese law) compelled it to conclude that the central government inheritance and gift laws had to prevail. Therefore, insofar as the executorship had yet to be performed, no prepayment self-assessments could be made by individuals who did not have heir (and therefore taxable person) status and may never do so.

3.6 Tax on fluorinated gases.- Regulations on Fluorinated Gases and the Greenhouse Effect do not prevent the specific tax being charged

Central Economic-Administrative Tribunal. Decision of December 15, 2020

TEAC examined whether the tax on fluorinated greenhouse gases has lost its purpose following the approval of the European Regulation on fluorinated greenhouse gases.

The tribunal concluded that the tax on fluorinated gases is fully applicable, in that approval of the regulation has not introduced any limit whatsoever on the taxing power of member states for establishing environmental taxes.

3.7 Management procedure.- An expense cannot be adjusted in a limited review because accounting records cannot be examined in these procedures

Galician Regional Economic-Administrative Tribunal. Decision of October 17, 2019

Following a limited review, an adjustment was made to an entity's tax position, increasing the corporate income tax base by the amount of certain expenses in respect of tax penalties and enforced collection surcharges.

The Galician TEAR, however, concluded that the adjustment was not correct, because a limited review procedure does not give the tax authorities the power to examine accounting records. These records needed to be examined to determine whether those expenses had been recognized.

3.8 Audit procedure.- A provisional assessment does not toll statute of limitations for right to assess

Central Economic-Administrative Tribunal. Decision of June 29, 2020

A company underwent a general tax audit in which, besides the final assessment in respect of the audited tax, two preliminary assessment reports were issued in which certain specific elements were adjusted in a few of the audited tax periods.

The Catalan TEAR considered that the final assessment had been notified after the tax authorities' right to assess had become statute-barred. In the later appeal, the tax authorities pleaded that the statute of limitations had not ended because the provisional assessments arising from the preliminary reports had tolled that period.

TEAC concluded however that because this was a single audit with a general scope, provisional assessments arising from preliminary reports drawn up in relation to a few elements of the main tax obligation being audited are only preliminary adjustments (with respect to the final assessment) and do not toll the statute of limitations for the right to assess.

3.9 Penalty procedure.- It is a tax infringement to issue forged invoices to obtain subsidies, even if they do not cause a loss for the finance authority

Central Economic-Administrative Tribunal. Decision of September 17, 2020

The tax authorities rendered a decision imposing a penalty in which it was determined that the audited company had issued invoices containing forged descriptions, dates or prices of the provided services, so that the customers on those invoices qualified undeservedly for various subsidy programs.

TEAC confirmed that the issuing of forged invoices or invoices with forged data is a tax infringement, regardless of whether or not they cause a loss to the finance authority, if they are used to accomplish a fraudulent aim. That fraudulent aim existed in this case and consisted of substantiating an undeserved right to subsidies.

4. Requests for resolution

4.1 Corporate income tax.- Tax treatment clarified of purchase of treasury shares under put option granted to shareholders

Directorate General for Taxes. Resolution V3348-20 of November 12, 2020

A company and its shareholders signed in 2007 an agreement granting a put option to shareholders on shares in the entity. This option could be exercised, when the time came, at a price that would be determined by reference to the company's EBITDA in various periods. Under the agreement, the company undertook to purchase the shares from shareholders who had exercised their option right, if no other shareholder wished to purchase them.

To analyze the applicable tax treatment, a report was requested from the Spanish Accounting and Audit Institute (ICAC), which noted that:

(a) At initial recognition, in respect of the undertaking to purchase the shares given by the company, a liability has to be recorded at fair value equal to the actual value of the estimated purchase price for the shares at which the put option will be exercised and which will be determined according to the option contract. For the balancing entry it proposed using account 107 "Undertaking to purchase treasury shares", which will be shown as a negative balance in net equity.

(b) Following its initial recognition, the liability must be measured at amortized cost; and the variation in value of liabilities must be recognized as a finance cost in the income statement, applying by analogy the principle determined by the ICAC for the recognition of participating loans.

(c) On the date the purchase occurs, two scenarios may arise: if the company purchases the shares, it will cancel the debt and reclassify the balance of account 107 to account 108 or 109 (treasury shares), whichever applies. If the shares are purchased by the shareholders, the company will cancel the debt by crediting account 107, and recognize the difference between both amounts in a reserves account.

Based on the ICAC's principle, the DGT concluded as follows:

(a) The finance costs that the company incurs will be tax deductible if the general requirements for deduction are met, although subject to the limit contained in article 16 LIS.

(b) If the company purchases its treasury shares and cancels the liability, no effect on the tax base will arise (article 10.3 LIS).

(c) If the company does not purchase the shares (because the shareholders purchase them), any reserves relating to finance costs that have been included in the tax base must be included in the same way in the tax base. However, any finance costs that have not been included in the tax base under article 16 LIS will not be included in the tax base for tax periods occurring after the liability is settled.

4.2 Corporate income tax.- DGT makes determination on eligibility for tax neutrality regime of a downstream merger and its effect on limit for deduction of finance costs on debts incurred to purchase shares

Directorate General for Taxes. Resolution V3290-20 of November 5, 2020

Company A controls a group of companies with five wholly owned subsidiaries and they all file joint returns. Company A's shares were purchased in December 2014 by company S, using borrowed funds, and a downstream merger was being considered in which company A would absorb company S. The absorbed company had tax loss carryforwards.

Company S's loan for purchasing its shares in A would gradually be repaid over 8 years, and the related interest would be paid in that period. The funding was 70% higher than the acquisition price.

The DGT allowed as a valid economic reason for the merger to be downstream a simplification of the process with respect to third parties because it allows the same name, legal position and business relationships to be kept by the absorbing company which had a higher asset size and number of clients than the absorbed company.

It added that the fact of the absorbed company having unused tax losses does not *per se* render invalid the right to claim the neutrality regime, in that its previous activities were to continue after the merger; all of which is subject to the merger not being carried out as part of a liquidation plan for any of the activities carried on by those entities or for the primary purpose of using tax loss carryforwards.

On the subject of applying the "additional limit" for the deduction of finance costs in the case of mergers, it stated that: “Under article 16.5 or article 83 LIS, depending on whether the transaction is subject to the special regime under Chapter VII of Title VII LIS, the finance costs relating to S's debt to purchase its shares in A would be tax deductible within the additional limit equal to 30 percent of the operating income of the company that made that purchase (S), unless the requirements are met for claiming the exception in paragraph three of the same article”.

4.3 Corporate income tax.- Patent-box reduction for licensing know-how has not been claimable since 2018, even if license agreements were signed earlier

Directorate General for Taxes. Resolution V3286-20 of November 5, 2020

A company signed know-how license agreements with its subsidiaries for terms running from 2017 to 2019.

As a result of the amendments introduced by the General State Budget Law for 2018, the income obtained from know-how licenses granted on or after July 2016 cannot benefit from the parent box reduction in tax periods that began on or after January 1, 2018. Licenses granted before July 1, 2016 are entitled to a transitional arrangement which as a general rule lasts until June 30, 2021.

In this case therefore the company could not claim the reduction in the 2018 and 2019 taxable periods, even if the income was obtained from a know-how license granted in 2017 for the period between 2017 and 2019.

4.4 Corporate income tax.- Share based incentives paid in cash are deductible where employees generate the right to receive them

Directorate General for Taxes. Resolution V3284-20 of November 5, 2020

A company grants its managers two special variable incentives (a phantom equity plan and a performance equity plan), which allows them to receive remuneration if the company increases in value. The right to receive the remuneration arises if a liquidity event occurs evidencing that increase in value; namely a distribution of dividends by the entity or a transfer of shares in the company to a third party. The incentive is paid in cash.

In a report requested from it on the accounting treatment of these incentive plans, the ICAC concluded that in these cases the company must recognize the services provided by the managers as a personnel expense against the associated liability, because it is a transaction based on the value of equity instruments to be paid in cash. If a certain service period needs to be completed to be entitled to the incentive, it must be recognized when the services are provided on an accrual basis.

Under paragraphs 3.e) and 5 of article 14 of Corporate Income Tax Law 27/2014, of November 27, 2014. (i) the expense is not deductible in the period it is recorded in the accounts; (ii) instead when the provision is used or the expense is allocated to its intended purpose, in other words, when the employee is entitled to receive the incentive, that is when the remuneration is payable.

4.5 Personal income tax.- Self-employed individuals cannot deduct utility costs at principal residences in which they are working due to COVID-19

Directorate General for Taxes. Resolution V3461-20 of November 30, 2020

A self-employed worker usually works from an office outside her principal residence. However, as a result of the situation caused by COVID-19, on a few days she does not go to her office and works from her residence which results in greater utilities costs (electricity, internet, etc.).

The DGT recalled that for a utility cost at a certain building to be deductible in relation to an economic activity for personal income tax purposes the building must be used in whole or in part for the activity.

This circumstance, according to the DGT, does not occur in the described case because the residence is not used in part for the activity and its utilization for that activity is due to a temporary and exceptional circumstance.

4.6 Wealth tax.- An employee hired full time, but with multiple employment, is not sufficient for leasing company to claim relief for family businesses

Directorate General for Taxes. Resolution V3319-20 of November 6, 2020

For the management of its business a property leasing company had an employee hired under a full-time employment contract. The employee already had another full-time employment contract with another employer for completely different activities. This case involved multiple employment, which arises where the employee has two full-time employment contracts at the same time.

A condition for claiming the wealth tax relief for family businesses is that the buildings must be used for the economic activity, for which the lessor must have an individual hired full time under an employment contract.

In relation to this requirement, the DGT specified that the employee is required to devote all their working time to the organization of the leasing activity. This implies that, if they devote a portion of their working time to carrying on their own professional activities or to the

organization of another of the taxpayer's activities, this requirement must be deemed not satisfied; a conclusion that is questionable in that it appears to confuse a full-time contract (which must be classified from the standpoint of labor and employment legislation) with an exclusive contract.

4.7 Inheritance and gift tax.- Taxation of inheritance according to the Spain-Sweden tax treaty is clarified

Directorate General for Taxes. Resolution V3310-20 of November 6, 2020

The requesting individual resides in Murcia and is the sole heir of her brother, tax resident in Sweden. Her brother died without a will. His estate consisted of two properties located in Sweden and of balances in bank accounts and investment funds listed on stock exchanges acquired through Spanish and Swedish banking institutions.

According to the Spain-Sweden tax treaty:

(a) Income from immovable property is taxed in the country where it is located.

(b) The balances in checking accounts are deemed to be located in Spain where the checking account was opened at a branch of a credit institution located in Spain, if the services representing the essential elements of the account agreement are provided mainly by that branch (which must be substantiated by the taxable person). The account agreement is deemed to be with the branch if the IBAN contains the branch's numerical characters.

(c) The shares in investment funds in a securities account opened at a branch in Spain are deemed to be located in Spain. However, if shares in investment funds are registered in the decedent's name on the fund manager's register, those shares will be deemed to be located on that register, in other words they cannot be deemed to be held in the branch's securities account.

The requesting individual is only liable for inheritance and gift tax in Spain on the assets and rights subject to the tax that are deemed to be located in Spain under the criteria described above.

Moreover, since the decedent is nonresident, the legislation of the autonomous community where the estate's assets and rights located in Spain with the greatest value are located may be applied. According to the DGT, this is a tax option to be elected by the parties with tax obligations, and therefore after electing the applicable legislation (or the central or autonomous community government), it cannot later be changed.

4.8 Tax on economic activities and waste collection fees.- The homes of employees working from home are not employer's premises

Directorate General for Taxes. Resolution V3293-20 of November 6, 2020

An entity's employees work from home. For a company subject to the local authority charge for the tax on economic activities, it was asked whether the employees' homes are premises where the activity is carried on for the purposes the tax on economic activities.

The DGT recalled that the connecting point for determining the place of the activity is the municipality where the establishment from where the service is actually provided is located. Establishments for these purposes are premises over which the taxable person holds, under any instrument, a right of use, which does not occur with the homes of its employees, over which the employer does not hold that direct right of use.

For this reason, employees' homes should not be notified as premises used for the business for the purposes of the tax on economic activities; and, for the same reason, the entity will not be required either to pay the local authority fee for the collection of urban solid waste in municipalities where it does not have an establishment, even if the homes of its employees from where they work remotely are located in them.

4.9 Local authority fees.- The waste collection fee may be divided among co-owners of a building, unless it is a non-tax levy

Directorate General for Taxes. Resolution V3281-20 of November 4, 2020

A building is owned by several co-owners. It was asked whether the local council is required to divide the bill for the solid waste collection charge among all the co-owners, as happens with the real estate tax bill.

DGT noted that any of the taxable persons may apply for division of the fee among the various parties with tax obligations, if the requirements laid down in article 35.7 of the General Taxation Law are met, in other words, whenever the personal particulars and the addresses of all parties with payment obligations are provided to the tax authorities, together the proportionate share held by each in the ownership or rights in the building.

However, if the solid waste collection service is not provided directly by the council itself, instead under any of the direct management mechanisms through an entity with a separate personality (business entity or government business enterprise wholly owned by a public authority) or through indirect management (such as an administrative concession), the consideration charged to users will not be treated as a public fee, instead as a non-tax levy. For that reason, because it is not a tax, article 35.7 LGT does not apply to it, therefore in relation to dividing the charge among the various parties with payment obligations, the provisions in the article governing that non-tax levy will apply.

5. Legislation

5.1 Approval of the Annual Tax and Customs Control Plan for 2021

The January 1, 2021 edition of the Official State Gazette (BOE) published the Tax Control Plan for 2021.

In our Alert on February 2, 2021, we highlighted the most relevant guidelines.

5.2 Filing period for January returns paid by direct debit extended due to storm Filomena

The January 14, 2021 edition of the Official State Gazette (BOE) published Order HAC/5/2021, of January 13, 2021, extending the direct debit payment period for the filing of certain tax returns and self-assessments, as a result of storm Filomena.

See our **Alert** dated January 14, 2021 for a summary of the main new provisions.

5.3 Brexit.- UK traders allowed to recover VAT incurred in Spain

A resolution was published on January 5, 2021 (Resolution by the Directorate General for Taxes of January 4, 2010 on VAT refunds to traders and professionals established in the United Kingdom of Great Britain and Northern Ireland).

See our **Alert** on January 5, 2021 for a summary of the main implications of this resolution.

6. Miscellaneous

6.1 Filing dates pushed back for first self-assessments of tax on financial transactions and digital services tax

On January 15, 2021, AEAT announced on its website that the filing dates for the first self-assessments of the tax on financial transactions and the tax on certain digital services had been pushed back. Our **Alert** drawn up on the same date lists the new filing dates for these self-assessments.

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