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2021 changes on Spanish rules for double taxation relief and how they may impact foreign investments in Spain

Spanish 2021 Budget Law has introduced new measures in the area of Corporate income tax that affect the mechanisms to avoid double taxation in the case of dividend distributions and capital gains deriving from shareholdings in either resident or non resident entities in Spain

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The tax treatment on dividends and capital gains exemption is modified:

- The reason for such new measure relies on qualifying management expenses referred to the shareholdings, which is fixed in the amount of 5% of the dividend amount / capital gain obtained, as non tax deductible. Hence, only 95% of the dividend or capital gain will be tax exempt as these will be subject to an effective Corporate income tax of 1.25%, (which will raise to 1.5% for banks and hydrocarbon entities).
- Investments having an acquisition value exceeding €20 million but not implying a significant share of 5% will no longer qualify as shareholdings eligible for the exemption. During a transitory period of five years though, (in fiscal years starting up to and including 2025), such investments, acquired before 1st Jan. 2021, shall still be entitled to the full exemption.
- Prior to these measures entering into force, a full exemption was applicable when there was a minimum 5% shareholding or the acquisition value was higher than €20 million and, in both cases, the interest was kept for one year.
- With the aim of permitting the growth of smaller sized companies, those with a turnover lower than €40 million and that do not form part of a group of companies, shall be entitled to a full dividend exemption, during a limited three years period, when they derive from a subsidiary, either resident in Spain or not, set up after Jan. 01, 2021.
- Despite these new measures, capital losses deriving from the transfer of shareholdings have remained as non – tax deductible, even if the exemption is limited to 95%. Such losses can only be deducted when the subsidiary is extinguished, in so far as it does not derive from a restructuring transaction as defined in the special entrepreneurial reorganization scheme (which affects mergers, for example), irrespective of whether or not it benefits from any tax deferral relief.
- The new measures do not foresee any limitation to the effective 1.25% Corporate income tax cost, in the event of in cascade ownership structures situated in the Spanish territory. These will be subject to tax in each link of the chain with its corresponding cumulative effect, in the event there may be successive dividend distributions, for example.

Spanish private equity companies subject to a special investment scheme in the Corporate income tax will benefit from an interesting misalignment caused by these new measures as significant investments having a 5% share will only benefit from a 95% exemption while those not qualifying as significant will benefit from the higher 99% exemption, that is ruled out in this special scheme.

- The new measures will also slightly affect investment vehicles such as the Spanish ETVE holding companies, as they will be subject to a tax toll of 1.25% while, to date, they permitted the flow of dividends or income deriving from capital gains fully exempted at the ETVE level. Dividend distributions remain exempt from Spanish withholding taxes, in so far as they derive from qualifying exempt ETVE income.

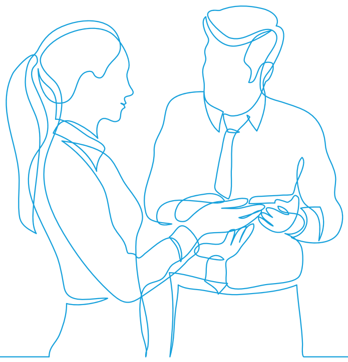
In tax consolidation schemes, 5% of dividends and capital gains deriving from subsidiaries qualifying for the exemption in intra group transactions shall not be eliminated either.

In line with the previous measures, the tax credit to eliminate double economic taxation on foreign sourced dividends is subject to the following changes:

- It is reduced to 95% of the tax quote that would be payable in Spain, when there is a significant share of 5%. This tax credit applies when the requirements to be eligible for the exemption are not met. Despite it permits deducting, at the parent company level, the foreign tax paid by the foreign subsidiary on profits out of which dividends have been distributed, it requires including such foreign taxes as taxable income. The foreign tax which is creditable against the final tax liability cannot exceed the theoretical tax quote that would correspond in Spain should such profits be obtained in the Spanish territory. With the new measures and in order to calculate such theoretical tax quote, dividends shall be reduced by 5% as management expenses, thus implying that the tax credit shall be limited to 95% of such theoretical quote.
- This tax credit mechanism shall no longer apply on holdings whose acquisition value exceeds €20 million but which do not imply a significant share of 5%. In a transitory period in fiscal years starting from 2021 through to 2025, the application of this tax credit is permitted on shareholdings acquired before Jan. 1st 2021.

Last but not least and in a flagrant exercise of double taxation, CFC rules (a sort of transparent scheme that levies certain income obtained by qualifying foreign subsidiaries at the Spanish parent company level) are also modified in the sense that 5% of the dividends deriving from profits taxed at the Spanish parent company due to the application of CFC rules do not benefit from the full previously existing non taxation.

Going forward, it will be strongly recommendable paying attention to the impact of such measures in the existing shareholding structures as well as on the appropriateness of modifying and simplifying any of such structures, in order to achieve major tax efficiencies in the returns of capitals invested.



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