

Impact of the state of alarm on corporate income tax
for the 2019 tax year

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The declaration of the state of alarm caused by the COVID-19 health crisis has led to the establishment of a series of temporary and extraordinary measures to protect the health and safety of citizens. The current situation is causing operational problems for the Spanish business sector as a whole, as well as significant cash-flow problems, and has forced many companies to seek external financing to sustain structural costs while revenue from business activities is unavailable.

In many sectors, these cash flow constraints may continue over the coming months, during which time Spanish companies must file their 2019 Corporate Income Tax (“CIT”) returns. The CIT assessment of the 2019 tax year may be significant since it is calculated on the basis of the accounting result obtained as of 31 December 2019 and may coincide with a very difficult financial period for Spanish companies.

Therefore, we would like to briefly summarise some of the effects that the state of alarm could have on the preparation and filing of the 2019 CIT return, as well as some tax incentives whose application can still be considered by taxpayers.

SUBMISSION OF THE CIT RETURN FOR THE 2019 TAX YEAR

As a result of the current situation caused by the COVID-19 health crisis, one of the measures established was the “suspension” of the deadline for the preparation and approval of annual accounts from the commercial and corporate point of view. In practice, this suspension may mean that annual accounts will likely be approved and filed with the Commercial Registry in the last quarter of the year (instead of in the first six months following the end of the tax period).

It is well known that the deadline for the filing of the CIT returns (within 25 calendar days after the 6 months following the end of the tax period, i.e. in the month of July) is closely related to the commercial deadlines for the preparation and approval of the annual accounts. This is because the CIT due is calculated on the basis of the accounting result for the year approved by the company’s governing bodies and supervised by the company’s auditors. Insofar as the deadline for the filing of the CIT has not been suspended or extended as of today, it is more than likely that the accounting result on which the CIT is calculated will be a provisional result, not approved or even audited from the commercial point of view.

Therefore, we consider that, for reasons of legal certainty, the government should approve measures aimed at eliminating the adverse tax and economic implications that taxpayers could face as a result of this situation in which the commercial and tax deadlines will not coincide. These measures could include the extension of the deadline for filing the CIT return or the suspension of the initiation of tax audit proceedings during such period or the elimination of surcharges for late returns filed for this reason.

IMPACT OF COVID-19 ON THE ACCOUNTING RESULT OF THE 2019 TAX YEAR

In general, in accordance with Spanish GAAP provisions, for those Spanish companies whose business year coincides with the calendar year (i.e. from 1 January to 31 December 2019), we understand that the COVID-19 situation should only entail the inclusion of an informative section called “events after the end of year period” in the annual accounts. Therefore, except in some specific cases, the economic impact that could arise from the declaration of the state of alarm and the health and economic crisis caused by COVID-19 will most likely affect the accounting result for the year 2020 and, consequently, the CIT liability for the year 2020 and its instalment payments (i.e. CIT payments on account).

It is in the CIT instalment payments of 2020 where the effects of COVID-19 are likely to unfold in one way or another (for example, provisions for processing employment regulation files or for new obligations or legal covenants with clients, accruals of income and expenses due to modifications in the terms of leases, compensation or aid received by public administrations, or possible changes in the measurement of variable considerations –for discounts or returns–).

These adjustments to the financial results could reduce the taxable base for CIT purposes and would have to be analysed on a case-by-case basis.

KEY TAX INCENTIVES TO CONSIDER

A. Capitalisation reserve

In these extraordinary circumstances, companies may decide not to distribute dividends and could opt to finance themselves from their own resources by allocating the 2019 financial results to legal or voluntary reserves, and it may, therefore, be time to reconsider the application of a tax incentive known as the “capitalisation reserve”. Such tax incentive consists of a 10% reduction in the increase in equity for the year, provided that such increase is placed in an unavailable “capitalisation reserve”.

Since the deadline for the preparation and approval of the annual accounts has been suspended, Spanish companies still have time to set up the corresponding capitalisation reserve and apply this tax incentive to the CIT return of the 2019 tax year. In the case of companies that have already proposed the distribution of 2019 accounting profits, under certain conditions, it is possible to amend this proposal without redrafting the annual accounts to provide for the capitalisation reserve.

It must be noted that one of the requirements to apply this tax incentive is the obligation to maintain the unavailable capitalisation reserve for five years. The failure to maintain such unavailable reserve as well as the relevant increase in the equity during the five-year period will result in the regularisation and payment of the unduly reduced amounts, together with the relevant delay interest for late payments. Therefore, if a company decides to allocate the capitalisation reserve in the 2019 financial year, it will be necessary to monitor the movement of equity on an annual basis, and the company's ability to make distributions to shareholders over this period will be compromised.

B. Monetisation of the R&D tax credit

The CIT Law provides that a 25% tax credit may be applied to expenses incurred in the tax period that qualify as R&D expenses. The monetisation of this tax credit can be requested by means of the submission of the CIT return. However, the request of the monetisation will automatically entail a 20% discount on the total deduction generated, if finally approved by the tax authorities.

Therefore, companies with R&D expenses may opt to apply for the application of this deduction, obtaining additional cash flow, with a "penalty" of 20% on the tax credit generated, meeting certain requirements established in the CIT Law, including an obligation to reinvest, and another obligation to maintain employment during a certain period of time.

C. Tax credits and tax losses incurred in tax years prior to 2019

In accordance with the recent case law of the Spanish National Court of Justice, it is possible to rectify a CIT self-assessment by recognising net operating losses generated in the last 10 years (even if statute-barred).

Therefore, in view of this judgment, it is possible to rectify the possible errors in relevant CIT self-assessments linked to net operating losses and tax credits related to years that were not time-barred. However, carrying out any actions in this regard must be carefully undertaken and in strict observance of the current tax regulations.

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