Legal Briefing
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MAIN TAX DEVELOPMENTS INCLUDED IN THE DRAFT GENERAL STATE BUDGET LAW FOR 2021

On 27 October 2020, the Council of Ministers approved the submission to the Parliament of the Draft General State Budget Law for 2021 (the **"Draft Law"**), which proposes the introduction of significant tax measures[1].

The purpose of this Legal Briefing is to summarise the main developments relating to tax included in the Draft Law. However, it is worth bearing in mind that the measures described below may change following the appropriate parliamentary process.

1. Personal income tax ("IRPF")

With regard to personal income tax, the following measures, which would take effect from 1 January 2021, have been proposed:

(i) Increases in rates applicable to general and savings tax bases

It proposes that Article 63 of the Personal Income Tax Act be amended to increase by two percentage points the taxation of the general tax base for income in excess of €300,000. Thus, if the current regional rates are maintained, the maximum income tax rate for residents in the Community of Madrid would rise from 43.5% to 45.5%, and from 48% to 50% in Catalonia.

This modification entails a correlative change in the scale of withholding taxes applicable.

A similar approach has been taken in relation to the savings tax base which, by means of the proposal to amend Article 66 of the Personal Income Tax Act, introduces a new section in the scale for income exceeding €200,000, which will be subject to taxation at 26% (three percentage points more).

[1] Draft General State Budget Law for 2021 is available here http://www.congreso.es/public_oficiales/L14/CONG/BOCG/A/BOCG-14-A-35-1.PDF

(ii) Increases in the rates of the regime for inbound expatriates

It proposes that Article 93 of the Personal Income Tax Act be amended to increase, in accordance with the previous scales, the tax rates applicable to workers posted to Spanish territory (commonly known as the "Beckham regime"). Thus, it proposes that taxpayers under this regime be taxed (i) at 47% for labour income exceeding €600,000 (currently 45%) and (ii) at 26% for income from savings exceeding €200,000 (currently 23%).

(iii) Modification of the limits established for the reduction due to contributions to pension plans

It also proposes modifying the limits applicable to reductions due to contributions to pension schemes under Articles 51 and 52 of the Personal Income Tax Act. The amount of the reductions applicable due to the participant's own contributions is reduced from €8,000 to €2,000 per year, and the contributions of a non-active spouse from €2,500 to €1,000 per year.

However, the joint limit (participant and company) of the reductions applicable due to contributions to pension schemes would be increased from €8,000 to €10,000 per year, provided that the excess of the contributions over the €2,000 foreseen for individual contributions corresponds to company contributions.

(iv) Extension of the exclusionary limits of the objective estimation method for personal income tax

It proposes that the quantitative limits on the volume of revenue from the previous year be extended for 2021 for the purpose of applying the objective estimate method in calculating the net revenue from economic activities (other than agriculture and livestock farming which have their own quantitative limit).

2. Corporate Income Tax

With effect for tax periods beginning on or after 1 January 2021 that have not ended by the date of entry into force of the General State Budget Law, the following measures are proposed:

(i) In relation to the requirement for a significant stake under Article 21.1.a) of the Corporate Income Tax Act, it is proposed that stakes with an acquisition value for tax purposes of over €20 million no longer qualify for the participation exemption, and that the exemption only apply in cases where the stake represents at least 5% of the entity's equity.

The same adjustment will apply to the tax credit to avoid international double taxation on dividends and capital gains.

However, a transitional regime is regulated for stakes acquired before 1 January 2021, so that they will also qualify for the application of the exemption during the tax periods starting within the years 2021 to 2025.

(ii) It proposes amending Article 21 of the Corporate Income Tax Act to limit the participation exemption for dividends and capital gains due to the transfer of shares (from resident and non-resident entities) to 95% of the revenue for this item. Until now, a 100% exemption was allowed[2].

However, the aforementioned 95% limitation on the exemption of dividends or shares in profits will not apply when the following circumstances occur cumulatively:

- The company distributing the dividend is incorporated on or after 1 January 2021.
- Dividends are received in the three (3) periods following the year in which the entity distributing them is incorporated.
- The company receiving the dividend meets the following requirements:
  - Its net revenue in the previous period must not exceed €40 million[3].
  - It must not be considered a holding entity (*entidad patrimonial*)[4].
  - It must not form part of a group of companies in accordance with Article 42 of the Commercial Code prior to the incorporation of the entity distributing the dividend.
  - It must not hold a significant stake[5] in another company prior to the incorporation of the entity that distributes the dividend.

[2] The reduction is justified by the deductible expenses involved in the management of the stakes.
Therefore, in the event that the same dividend is distributed through chains of companies that are resident for tax purposes in Spain, the effective taxation would be applied at each level, meaning that it may be appropriate to consider a simplification of corporate structures.

[3] Determined in accordance with Article 101.2 of the Corporate Income Tax Act.

[4] In accordance with Article 5.2 of the Corporate Income Tax Act.

[5] Direct or indirect stake or stake equal to at least 5%.

(iii) The same limitation will apply to the tax credit to avoid international double taxation on dividends and capital gains governed by Article 32 of the Corporate Income Tax Act on the total tax liability, the basis of calculation of which will be reduced by 5%, thus reducing the effective amount of the deduction.

(iv) It proposes amending Article 64 of the Corporate Income Tax Act in relation to the tax consolidation regime in such a way that revenue to be included in the consolidated tax base will not be eliminated for tax purposes due to the 95% limitation on the exemption for dividends and capital gains. With this amendment, intra-group revenue of this nature will have the same tax treatment as if the corresponding entities were not part of the consolidation group.

(v) With certain particularities, 5% of dividends and shares in profits received by entities under the international tax transparency regime will also be subject to taxation.

(vi) It also proposes that the method of calculating operating profit provided for in Article 16 of the Corporate Income Tax Act for determining the deductibility of financial expenses be modified in such a way that the dividends and shares in profits to be included in operating profit will be exclusively those derived from significant stakes[6] (excluding stakes whose acquisition value for tax purposes exceeds €20 million) not affected by the limitation in Article 15.1.h of the Corporate Income Tax Act.

3. Non-resident's Income Tax ("IRNR")

With effect from the entry into force of the General State Budget Law, it is proposed that the following measures be introduced:

(i) Adaptation of the exemption from withholding tax on interest paid from Spain to an EEA resident

The exemption from withholding tax for interest and other income obtained from the transfer to third parties of equity capital and capital gains derived from movable property obtained without a permanent establishment paid by residents in Spain, provided for in Article 14.1.c) of the Non-resident's Income Tax Act for EU residents, is extended to residents of EEA states with effective exchange of information, who will be able to apply the exemption on the same terms as EU residents.

[6] Direct or indirect stake or stake equal to at least 5%.

(ii) Modification of the status of non-resident parent company for the purposes of the exemption on profits distributed by subsidiary companies which are resident in Spain

Following the amendment of Article 21 of the Corporate Income Tax Act, stakes with an acquisition value exceeding €20 million that do not reach the minimum percentage of 5% no longer qualify for the exemption regulated in Article 14.1.h) of the Non-resident's Income Tax Act (exemption of dividends distributed by subsidiaries resident in Spain to their parent companies resident in other EU or EEA States with effective exchange of information).

However, a transitional regime is regulated for stakes acquired before 1 January 2021, so that they will also qualify for the application of the exemption during the tax periods starting within the years 2021 to 2025.

Therefore, the exemption from the withholding obligation for the distribution of dividends by subsidiaries resident in Spain to their EU-resident parent companies has not been quantitatively limited.

4. Value added tax ("VAT")

(i) Tax rate applicable to sweetened drinks

It proposes increasing the tax rate applicable to beverages containing added sweeteners, whether natural or artificial, from 10 to 21 per cent. This does not apply to infant milks and drinks which are considered food supplements for dietary needs.

However, the tax rate of 10% is maintained when these sweetened drinks are consumed in catering and hotel establishments.

The measure will enter into force with the approval of the General State Budget Law and will be valid indefinitely.

(ii) Modification of the rule of effective use

It proposes that the wording of Article 70.2 of the VAT Act be amended so that the rule of effective use no longer applies in respect of the Canary Islands, Ceuta and Melilla. Thus, business owners or professionals based in the aforementioned territories will not be taxed in the territory of application of the tax for services which are effectively used therein.

The measure will enter into force with the approval of the General State Budget Law and will be valid indefinitely.

(iii) Extension of the exclusionary limits of the simplified VAT system

It also proposes, with effect from 1 January 2021, to amend the thirteenth transitional provision of the VAT Act in order to extend the increase in the limits determining exclusion from the simplified regime and the special regime for agriculture, livestock and fisheries for the 2021 financial year.

5. Special Taxes

As regards the tax on mineral oils, it proposes increasing the general rate for diesel by 3.8 cents / litre (from 30.7 to 34.5 cents / litre) and the general rate for biodiesel by 3.8 cents / litre (from 30.7 to 34.5 cents /litre). This measure will enter into force with the approval of the General State Budget Law and will be valid indefinitely.

With regard to the Special Tax on Electricity, the inclusion of two new exemptions has been announced concerning electricity produced and then consumed on board vessels, and supplied electricity that is compensated with the surplus hourly energy. A reduction in the tax base on electricity supplied or consumed in rail transport is also included.

6. Wealth Tax

With effect from the entry into force of the General State Budget Law and with indefinite validity, it proposes increasing from 2.5 to 3.5 per cent the state tax rate for taxpayers whose taxable income exceeds €10,695,996.06. All of this is without prejudice to allowances that may be applicable in accordance with legislation in each region.

It also establishes the indefinite validity of the tax, thus avoiding annual extensions.

7. Business Activity Tax (“IAE”)

With regard to the IAE, the creation of new headings or groups under the Tariffs is proposed. The most significant change is to specifically classify the marketing activities of gas and electricity supplies that until now lacked a specific classification. A heading is also created for the new activity of electric vehicle recharging points installed in establishments or premises. Lastly, a specific heading is added for shops in large shopping centres.

8. Stamp Duty

The Draft Law proposes an increase of 2 per cent in the scale of charges applicable to the Stamp Duty for the restoration and transfer of noble titles.

9. Taxes on insurance premiums

It proposes that the tax rate on insurance premiums be increased from 6 to 8 per cent.

10. Other measures

The Draft Law also has an impact on several duties and charges, including the duty on games of luck or chance, the duty on reserving the radioelectric public domain or the duty on the licensing of railway companies.

The tax delay interests remains at 3.75% until 31 December 2021.

11. Other tax measures not included in the Draft Law

In addition, the following measures are expected to be included during the processing of the Draft Law on measures to prevent and combat tax fraud: (i) giving the Tax Agency Inspection Authorities the power to check that SICAVs (collective investment vehicles) comply with the requirements for setting up collective investment vehicles, thereby strengthening the control of such vehicles, and (ii) imposing a 15% tax on the profits of SOCIMIs (Spanish REITs) not distributed as dividends to their shareholders.

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The information contained in this Briefing is of a general nature and does not constitute legal advice. This document was prepared on 30 October 2020 and Pérez-Llorca does not undertake any commitment whatsoever to update or review its content.

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