SPAIN

SPAIN

INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

A new Corporate Income Tax (CIT) Act, which was approved on 27 November 2014 and entered into force on 1 January 2015, has substantially modified the CIT regime previously in force. Likewise, certain tax measures modifying the CIT Act were approved in December, 2016.

The main aspects being modified 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.
- Losses on the transfer of investments qualifying for the participation exemption or permanent establishments are non-deductible (measure in force for fiscal years commencing on or after 1 January 2017),
- 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 amortisation 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 and losses on the transfer of 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 PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

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, patent box and transfer pricing rules were modified as well to adapt them to the OECD BEPS recommendations.

The above anti-abuse rules have not been included in the Basque CIT regulations, except for those related to patent box and transfer pricing.

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. Likewise, Spain is a member of the OECD and of the Ad Hoc Group participating in the process of adoption of the Multilateral Instrument. Thus, the Spanish DTT network will be modified after the entry into force of the Multilateral Instrument. The scope of these modifications is still uncertain.

As 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.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. Share deal

Tax advantages:

Acquisitions of shares generally do not have immediate implications for the buyer.

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.

The target is entitled to carry over its tax attributes (such as NOLs or tax credits). In Spain NOLs can be carried forward with no time limit (the carryback is not permitted). However, the amount of NOLS yearly offset is limited.

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

Tax disadvantages:

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

B. Asset deal

Tax advantages:

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.

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). 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.

Tax disadvantages:

The target's existing tax attributes, such as net operating losses (NOLs) do not carry over to the buyer.

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.

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).

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.

BUY-SIDE

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 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 AMORTISATION 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 1 January 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. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

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 except if the taxpayer evidences the existence of valid economic reasons for performing these transactions.

Net borrowing costs over and above a ceiling equal to 30% of the operating income for the period are not deductible. This ceiling has been established subject to the following rules:

- Net borrowing costs for the tax period amounting to EUR 1 million or less will be deductible in all cases;
- The portion that is not deducted in one period can be deducted in another period when operating income is higher or borrowing is lower applying certain rules.

The above ceiling will not apply to credit institutions and insurance companies.

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 tax unit 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, which have substantially restricted the ability of companies to push down debt connected to acquisitions of equity interests by Spanish companies.

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 specific limitations to the deduction of interest in cases of acquisitions of holdings in other entities do not apply.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

No

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

Generally speaking, they are. However, anti-NOL trafficking rules apply where all of the following circumstances occur:

1. 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.
2. The persons/entities 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.
3. 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.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

No, there is not specific documentation to be required.

The statute of limitations in Spain is four years. Thus, a review of all tax obligations of the last 4 tax periods opened to a tax audit is required. Exceptionally, in Spain, the right of the Spanish Tax Authorities to audit NOLS and tax credits 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 or tax credit was generated. Once the 10-year period is expired, the Spanish Tax Authorities are not entitled to audit NOLS or tax credits; nevertheless, the taxpayer must be capable of demonstrating the origin of the tax losses or tax credit which it is willing to off-set with the exhibition of the tax return and accounting records.

In the framework of an asset deal, the certificate of pending liabilities (see section 3).

11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

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.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX 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.

Impairment losses on shares are non-deductible (Under Basque CIT impairment losses on shares are tax deductible).

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

In an asset deal, 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 favor 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 favor of the taxpayer (in practice, the term is reduced after the Spanish Tax Authorities approve the first refund).

A share deal is exempt from VAT.

14. ARE THERE ANY PARTICULAR TAX 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.

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.

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.

15. CAN THE GROUP REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

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.

Likewise, Spanish companies with a common dominant company (holding at least a 75% stake – 70% for entities listed on a stock exchange) can apply the Spanish tax unit regime.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH 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 exempt 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.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

Spanish companies can form a group and apply a special tax unit regime for CIT purposes. Certain formal requirements must be fulfilled the year before its application.

The tax group is formed by a dominant company and its dependent companies. The dominant company of the tax group must hold a 75% or higher interest, either directly or indirectly, and the majority of the voting rights in the dependent companies at the beginning of the first tax year in which the tax unit regime is applied, and this interest and voting rights must be maintained during the year unless the dependent company is dissolved. The interest requirement is reduced to 70% for companies listed on a stock exchange.

A non-resident company can also be the dominant company of a tax consolidation group, provided that it has legal personality, is subject and not exempt to a tax akin to Spanish CIT, and is not resident in a tax haven. In such case, a representative company in Spain must be appointed.

The main characteristics of the tax consolidation regime are as follows:

- The taxable income of the tax group is the sum of the individual taxable income of each of the Spanish companies forming the group.
- The tax losses of any of the companies forming the group can be offset against the tax profits of any of the other group companies.
- In order to determine the tax group taxable income, transactions carried out between group companies are eliminated or deferred. They will be added afterwards under certain circumstances.
- Certain rules apply as regards tax losses and tax credits generated prior to the incorporation of a company to a tax unit.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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 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 EUR 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.

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.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES ARE REINVESTED?

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.

20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING 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 organisation 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).

21. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

Spain has implemented the provisions of the EU Merger Directive in its domestic system. Consequently, Spanish companies can reorganise its Spanish activities in a tax neutral manner.

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.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Incentives are granted to managers in order to align the interest of the investors and the managers.

Generally speaking, remunerations derived by the managers are treated as employment income and subject to Spanish Personal Income Tax at the general rate (progressive rate which ranges from 19% up to 52%, depending on the Autonomous Region of tax residence of the manager). A 30% reduction may be applicable for certain long-term incentives. (In the Basque territories reductions up to 50% may be applicable for certain long-term incentives).

Managers can also be remunerated acquiring a stake in the target. The acquisition of a participation at a cost under market value will also be treated as an employment income subject to Spanish Personal Income Tax general rates (see above). The capital gain triggered on the sale of the stake acquired will be taxed at the reduced tax rate applicable for saving income (ranging from 19% up to 23%).

From a Spanish CIT perspective, long-term remunerations are tax deductible when the incentives are satisfied to the managers.

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