New tax measures introduced by law 14/2013 of 27 september 2013, on support for and the internationalisation of entrepreneurs

1.- Introduction

Law 14/2013 of 27 September 2013, on support for and the internationalisation of entrepreneurs (hereinafter "the Entrepreneur Law") was published in Spain's Official State Gazette on 28 September 2013.

This alert sets out the changes to Spanish Corporate Income Tax (CIT) brought in by the Entrepreneur Law, namely: i) the tax credit for research, development and technological innovation activities ("R&D&I"); ii) the reduction of amounts earned on certain intangible assets ("patent box"); iii) the tax credit for the creation of jobs for disabled workers; iv) the tax credit for the investment of profits; and v) other changes.

Please note that this alert does not discuss the changes to taxes other than CIT or any non-tax-related measures.

2.- Tax credit for research, development and technological innovation activities ("R&D&I")

Article 44 of the Spanish CIT Law (hereinafter "the CIT Law"), approved by Royal Legislative Decree 4/2004 of 5 March 2004, establishes common rules on tax credits aimed at incentivising certain activities.

Specifically, section 1 of Article 44 of the CIT Law states that, as a general rule, tax credits aimed at incentivising certain activities are capped at 35% (25% for tax periods commencing in 2012 and 2013[1]) of gross tax due less tax credits to avoid double taxation and allowance (i.e. "reduced tax due"). This limit is exceptionally increased to 60% of reduced tax due (50% in tax periods commencing in 2012 and 2013[2]) in the event that the taxpayer is entitled to a tax credit exceeding 10% of reduced tax due as a result of expenditure on and investment in R&D&I activities in the same period[3].

Under the Entrepreneur Law, entities taxed either at the general CIT rate (30%), at a rate of 35% or at the rate foreseen in article 114 of the CIT Law (SMEs) may opt not to apply these limits (35%/60% or 25%/50%) to the tax credit for R&D&I activities generated in tax periods commencing from 1 January 2013 onwards. An entity availing of this option should apply this R&D&I tax credit reduced by a 20% discount.

The Law also contains a significant new measure providing companies with the possibility of "cashing in" on R&D&I tax credits. That is, companies unable to apply the tax credit due to an insufficient amount of CIT due may apply to the Tax Authorities requesting payment of the tax credit amount.

The amount of the tax credit applied or paid under the terms of the preceding two paragraphs may not exceed Euros 1 million per year in the case of technological innovation activities or Euros 3 million per year for R&D&I activities as a whole. These limits are to be calculated at group level for companies that fall under the scope of Article 42 of the Spanish Code of Commerce.

To avail of this option, taxpayers must meet certain requirements:

i) At least one year must have elapsed since the close of the tax year in which the tax credit was generated but not applied;

ii) The average headcount (either the total workforce or the employees assigned to R&D&I activities) must be maintained from the close of the tax period in which the tax credit is generated until the expiry of the period specified in point iii);

iii) An amount equivalent to the tax credit applied or paid must be invested in R&D&I activities (expenditure on or investment in property, plant and equipment or intangible assets for sole use in such activities, excluding real estate) within 24 months from the close of the tax period for which the CIT return includes the application or payment in question; and

[1] A Bill establishing certain environmental tax measures and introducing other tax and financial measures proposes that the application of this 25% (rather than 35%) limit be extended to tax periods commencing in 2014 and 2015.

[2] The same Bill also proposes that the 50% (rather than 60%) limit be extended to tax periods commencing in 2014 and 2015.

[3] Although Article 42 of the CIT Law does not state that these limits (35%/60%) apply to the tax credit for the reinvestment of extraordinary profit, this tax credit is, however, covered by the 25%/50% cap applicable to tax periods commencing in 2012 and 2013 (the aforementioned Bill also proposes that this limit be extended to tax periods commencing in 2014 and 2015).

iv) The company must obtain a reasoned report justifying the classification of the activity as R&D or technological innovation, or a previous valuation agreement on the expenditure on and investment in these activities.

In the event that a company fails to meet any of these requirements, it will be required to correct any amounts unduly applied or received and pay any tax credit applied plus late payment interest.

3.- Reduction of earnings from certain intangible assets ("patent box")

The Law modifies previous provisions for the reduction of income from certain intangible assets (set out in Article 23 of the CIT Law), which will now be known as the "reduction of earnings from certain intangible assets".

The main new features of this system, commonly known as the "patent box" regime, are as follows:

- The reduction will be applied to net earnings (rather than gross income) on intangible assets, and will be 60% (rather than 50%) of these net earnings. For the purposes of this provision, net earnings on the assignment of usage or operation rights will be understood to be the income received reduced by the amortisation, or impairment of the asset and any expenses for the reporting period relating directly to the asset assigned. In the case of assets not recognised on the company's balance sheet, the net earnings will be understood to constitute 80% of the income received on the assignment.
- The time limit for the application of this reduction has been eliminated. In other words, it is no longer specified that the reduction will cease to apply as of the tax period following that in which the income earned on the assignment exceeds six times the cost of the asset created.
- With respect to the requirement that the intangible asset be created by the company, the Law specifies that the company's stake in its creation must be at least 25% of its cost.
- The reduction may be applied to earnings obtained on the transfer of intangible assets provided that the transfer does not take place between group entities as defined by article 42 of the Spanish Code of Commerce (regardless of residency or whether there is any obligation to prepare consolidated annual accounts).
- The Law eliminates previous provisions to the effect that, in transactions between entities taxed under the consolidated regime, income and expenses derived from the assignment would not be eliminated on the calculation of the tax group's taxable base. It instead establishes an obligation to document (Article 16.2 of the CIT Law) the transactions that give rise to the application of the "patent box" regime in the case of entities taxed under the consolidated regime.
- The Law introduces the possibility of applying to the tax authorities requesting the adoption of advance pricing agreements in relation to the income derived from the assignment of assets and the corresponding expenses, as well as on any amounts earned on their transfer. It also foresees the possibility of requesting a prior agreement qualifying the assets as intangible assets eligible for the application of this tax incentive.
- One of the requirements for the application of this reduction is that the assigning party does not reside in a zero-tax territory or tax haven. This requirement is developed further by this Law, which states that it may also be applied if the assigning party is "*located in a European Union Member State and the taxpayer provides evidence that the reasons for the operation are economically sound*".
- This reduction will be incompatible with the tax credit for reinvestment of extraordinary profit.

These changes will apply to assignments of intangible assets that take place from the date on which the Entrepreneur Law enters force, i.e. from 29 September 2013. The previous wording of Article 23 of the CIT Law – i.e. the version predating this change (fortieth new transitional provision of the CIT Law) – will continue to apply to any assignments of usage or operation rights over intangible assets carried out prior to the adoption of the Entrepreneur Law.

4.- Tax credit for the creation of jobs for disabled workers

Article 41 of the CIT Law established a tax credit of Euros 6,000 per employee/year in which the average number of disabled employees in the company's workforce increases.

The Entrepreneur Law replaces this with a new tax credit based on the employees' disability grading. For tax periods commencing from 1 January 2013 onwards, the tax credit is Euros 9,000 per employee/year in which the average number of employees with disabilities graded between 33% and 65% increases, whereas the tax credit applicable in the case of disabilities graded 65% or higher will be Euros 12,000.

Finally, as per the previous wording of article 41 of the CIT Law, any employees who give rise to entitlement to this tax credit may not be counted for the purposes of applying the accelerated depreciation option included among the tax incentives available to small companies (Article 109 of the CIT Law).

5.- Tax credit for the investment of profits

This Law introduces a new tax credit for the investment of profits by entities taxed under the special regime known as "Tax incentives for small companies", applying a CIT rate of 25% up to Euros 300,000 and 30% above that amount.

Under these new rules, which will apply to tax periods commencing on or after 1 January 2013, tax credit may be made for up to 10% of the profit for the year – not including CIT recognised in the accounts – reinvested in new property, plant and equipment or investment property for business purposes. This maximum tax credit is reduced to 5% in the case of "micro-enterprises" (i.e. entities taxed at a rate of 20% up to Euros 120,202.41[4] and 25% above that amount).

A number of considerations must be taken into account in the application of this tax credit:

- To determine the tax credit base, a coefficient is to be applied to the amount of pre-tax profit invested. The numerator used to calculate this coefficient is the pre-tax profit less any income not included in the taxable base (as a result of exemptions, reductions, monetary corrections, credits or deductions) or that give rise to the right to apply tax credit to gross tax payable, and the denominator is the amount of pre-tax profit. By default, the result of this calculation will be rounded off to two decimal places to give the applicable coefficient.
- The tax credit is to be applied to gross tax payable for the tax period in which the investment takes place.
- The investment must take place between the commencement of the tax period in which the profit is earned and the two subsequent years. In exceptional cases, the authorities may agree to extend this period to allow for a special investment plan at the taxpayer's request.
- The investment is considered to have taken place on the date the asset becomes available to the taxpayer. In the case of finance leases that fall within the scope of section 1 of the seventh additional provision of Law 26/1988, the tax credit is ultimately conditional upon the exercise of the purchase option.
- To apply this tax credit, taxpayers must set aside an investment reserve for an amount equal to the tax credit base. This reserve, which must be charged to the profit for the year in which the profit to be invested is earned, may not be distributed throughout the period over which the taxpayer is required to maintain ownership of the assets in which this investment is made.
- Items in which profit is invested must remain in operation as part of the entity's assets, except in the event of justified loss, for five years, or for their useful life if shorter. If an asset is transferred before this period elapses, the taxpayer will not lose the right to apply this tax credit provided that the consideration received, or the net book value of the asset if lower, is invested under the terms established in article 37 of the CIT Law.
- This tax credit is not compatible with the right to apply accelerated depreciation, the tax credit for investment in the Canary Islands or reserves for investments in the Canary Islands.
- Taxpayers are required to include certain information in the notes to their annual accounts throughout the period over which the assets subject to this investment must be retained.
- In the case of companies taxed on a CIT consolidated basis, the tax credit base is calculated using the profit of the tax group as a whole, and any entity from the consolidated tax group may carry out the investment. It is the entity that makes the investment that must set aside the non-distributable reserve (if this is not possible, another group entity must create the reserve).
- In the event of failure to meet any of the above requirements, the taxpayer will lose the right to apply this tax credit and be required to repay any tax credit applied plus late payment interest.

6.- Other changes

- Article 44 of the CIT Law has been revised and now states: "*Unless expressly specified, a single investment may not give rise to the application of more than one tax credit by the same entity*".
- A nineteenth additional provision was added to the CIT Law by Article 7 ("Incentives for new companies") of Law 11/2013 of 26 July 2013, which set out measures to support entrepreneurs and stimulate growth and job creation. This additional provision established a super-reduced tax rate (15% up to Euros 300,000 and 20% in excess of that amount) for the first tax period in which the new business generated a positive taxable base and the tax period immediately following. Whereas new businesses "*taxed at a rate other than the general rate*" were not permitted to apply these super-reduced rates under this Article 7, the Entrepreneur Law replaces this wording with "*taxed at a lower rate*", thus allowing for the application of the super-reduced rate by entities generally taxed at a rate higher than 30% (e.g. businesses taxed at 35%). The new Law also eliminates the references to co-operatives included in the aforementioned additional provision.

[4] Euros 300,000 for tax periods commencing in 2013.