# *Invest in Gran Canaria*

## *Annex I : The tax system applied in Gran Canaria*

**Cabildo de Gran Canaria**

**Sociedad de Promoción Económica de Gran Canaria**

This document was updated as of the 25th of February of 2013

# Contents

# Chapter 1

# Introduction

# 1. Introduction

Spain counts with a tax system that is modern and has been harmonized with the legislation of the European Union, and also has one of the most advanced Tax Agencies in Europe. The Canary Islands is included within the scope of the Spanish tax system, and hence applies the same rules of general application in Spain. Nevertheless, the Canary Islands have certain tax benefits that shape the Economic and Tax Regime of the Canary Islands, which has been configured following a double purpose: promoting the productive investments in the Canaries, and reducing significantly the tax burden in the Canary Islands. Throughout the following sections, besides explaining the general issues, formalities and material requirements of the main taxes applied in Spain, we will stress the specific tax benefits of the Canary Islands for each one of the taxes mentioned.

In this sense, we enclose below two synoptic tables in which it is offered an overview of the main taxes that constitute the Spanish tax system, and its singularities in the Canaries, as well as a brief explanation of the tax incentives.

In the first place, it is offered an overview of the main taxes applied in Spain, along with the singularities or advantages in the Canary Islands:

| Tax | Description | Tax rates | Singularities/Advantages of the Canary Islands |
|---|---|---|---|
| Corporate Income Tax | Applied on the net income obtain by companies in Spain- | 30percent (general rate)<br>20percent-25percent for small companies<br>15percent for new companies | There are several exclusive tax benefits: Special Canary Zone, Reserve for Investments in the Canary Islands, Tax Benefit for the production of corporal goods, Tax Credit for investments in fixed assets, other improved tax credits, Special Ship Register. |

| | | | |
|---|---|---|---|
| Personal Income Tax | Applied on the income obtained by individuals in Spain | 21percent-27percent fixed tax rate for capital and savings income<br>24,75percentpercent-53,08percent for general income | Tax credits specific for the Autonomous Community<br>The taxpayers that perform business activities can apply the RIC, the tax credit for investment in fixed assets, and the improved tax credits in the Canary Islands |
| **Tax** | **Description** | **Tax rates** | **Singularities/Advantages of the Canary Islands** |
| Non-Residents Income Tax | Applied on the income obtained by a non resident, which is deemed to have been obtained in Spain. The tax treatment is different depending on the existence or not of a permanent establishment | 24,75percent without permanent establishment (general rate)<br>21percent without permanent establishment, for capital gains and other capital income<br>30percent with permanent establishments, plus 21percent for the transfer of capitals out of Spain | If the business activity is made through a permanent establishment located in the Canary Islands, it can be applied the RIC, the tax credit for investment in fixed assets, and the improved tax credits in the Canary Islands |
| Inheritance and Donations Tax | Applied on the inheritance and donations made in favour of individuals | Progressive scale from 7percent to 34percent, although depending on the age, kinship and wealth of the beneficiary the tax rate can reach 81.6percent | There are tax credits specific for the Canary Islands that reduce the tax cost |
| Canary General Indirect Tax | Indirect Tax, very similar to the VAT, but specific to the Canary Islands | General rate is 7percent<br>Special tax rates for certain goods 0percent, 2,75percent, 3percent, 9,5percent, 13,5percent (tobacco, 20percent) | Tax rates are far lower than VAT.<br>Despite it does not belong to VAT territory, this tax is fully coordinated with the VAT and its regulation is very similar.<br>There are exemptions related to certain investments |
| AIEM | Indirect Tax that applies only to a limited list of products whose local production is protected in the Canary Islands | 5percent to 20percent, depending on the product | Tax applied only in the Canaries and for a limited list of products |
| Transfer tax and Stamp Duty | Indirect tax applied on certain transfers of property (not taxed by IVA or IGIC), certain Corporate operations and certain notary documents and others | Transfers of property: 4percent-6.5percent<br>Corporate Operations: 1percent<br>Documents: 0.75percent general rate, other rates for specific documents | There are exemptions related to certain investments |

| | | | |
|---|---|---|---|
| Special Taxes | Taxes levied on the use or consumption of certain products. In the Canary Islands, only applied on electricity, alcohol and alcoholic beverages, transportation means, and fuel deriving from petrol | Rates very specific for each product | Tax rates in the Canary Islands are lower than in the rest of Spain |

In the second place, we resume the main aspects of the tax benefits of the REF:

| REF incentive | Description | Advantage |
|---|---|---|
| Special Canary Zone (ZEC) | The Special Canary Zone is a low taxation area in the Corporate Income Tax (4percent), conditioned to the execution of minimum investments and jobs creation | Perfect tax benefit for foreign investments, which gives high tax benefits requiring small investment and job creation |
| Reserve for the Investment in the Canaries (RIC) | The Reserve for the Investment in the Canaries is a tax benefit in the Corporate Income Tax that allows a reduction of up to 90percent of the taxable base (also in Personal Income Tax, up to 80percent of the tax payable), of the non distributed profit which is allocated for the execution of the so called initial investments, or investments qualified as running aids, | Very powerful tax benefit that promotes the capitalization of businesses in the Canary Islands, as its main requirement is the reinvestment of profits in certain assets. This way, an environment attractive for local or foreign investments is procured |
| Tax credit for Investment in Fixed Assets in the Canary Islands | Tax benefit in the Corporate Income Tax and Personal Income Tax, consisting in a tax credit of 25percent of the investment in fixed assets allocated to the development of a business activity performed in the Canaries | Very powerful tax benefit, which is also flexible and with immediate effect, as the tax credit is accrued in the same Fiscal Year in which the investment is executed |
| Improved Tax Credits for Investments in the Canary Islands | It is an improvement over the tax credits common in Spain related to certain investments and activities (p.e., labour formation, or R+D) The increase is 80percent with a minimum of 20 percentage points in the tax credit rate. | It is a substantial improvement over the tax credits applied in the rest of Spain |
| Tax Benefit for the production of corporal goods in the Canary Islands | Tax benefit in the Corporate Income Tax that allows a reduction of 50percent of the gross tax payable deriving from profits obtained in the production of corporal goods in the Canary Islands | Promotes productive and manufacturing activities, reducing in 50percent the tax applied to the profits obtained from the development of said activities |
| Special Ship Register (REB) | Among other tax benefits, this regime allows a reduction of 90percent of the gross tax payable in the Corporate Income Tax for the operation by shipping companies of the ships registered in the REB | Tax benefit whose purpose is to improve the competitiveness of shipping companies located in the Canary Island, along with the ports of the Archipelago |
| Customs-free area of | The Customs Free Area is a zone | Very adequate for logistic |

| | | |
|---|---|---|
| Gran Canaria | allocated within the customs area, where it is possible, without a time limit, to store, transform and distribute merchandise, without levying customs duties, nor other indirect taxes | international operations, transformation processes of raw materials of non-European origin, and other manufacturing processes |
| Indirect Taxes (ITP-AJD and IGIC) | Certain investments pertaining to business establishments located in the Canaries can benefit from exemptions on Transfer Tax (ITP-AJD) or IGIC (VAT for the Canary Islands) | This tax benefit pursues the reduction of the transaction costs in the acquisition of fixed assets used in a business establishment |

Furthermore, it must be borne that one of the issues that is usually subject to an special attention in foreign projects of investments, is the one related to the taxation of the return of the profit obtained in the investment in Spain to the foreign investor. This issue is considered in the Spanish tax system, which establishes mechanisms that mitigate or even eliminate fully any double taxation borne by the dividend paid or the capital gain obtained in the sale of the Spanish subsidiary. Also, if it were the case of a permanent establishment located in Spain, in some circumstances (mainly, if the parent company is resident in the European Union) it is possible to eliminate fully the taxation of the refund of the income obtained from the Spanish establishment to its parent company. On the other hand, it must be taken into account that Spain maintains an extensive net of Double Taxation Treaties, signed with the most relevant countries in the world, under the auspices of the Models of Tax Treaty of the OECD.

On the other hand, it must be noted that the REF tax benefits are considered an State Aid granted by the European Union through an Authorization of the Council, taking into account the situation of the Canary Islands as an Ultraperipheric Region of the European Union. In this sense, the present valid authorization extends its effects to the period 2007-2013, and the renewal for the following period is currently under negotiation.

In the following sections we will explain the most relevant characteristics of the Spanish tax system, making a difference between direct taxation (that is, taxes that rely directly upon the obtaining of income) and indirect taxation (which tax the use or display of the income obtained). In this sense, it must be stressed that there are certain taxes which have a specific regulation for the Canaries, such as the application of IGIC instead of the Spanish VAT, or the particular treatment given to the Special Tax on fuel deriving from petrol, and the Special Tax on tobacco, that establishes a tax burden far lower than in the rest of Spain.

Finally, we offer a detailed analysis of each one of the tax benefits that are specific to the Canary Islands REF, distinguishing between benefits for direct taxation or indirect taxation, and making

also a thorough analysis of the specific regimes which introduce tax benefits for several taxes at the same time (such as the ZEC, the Special Ship Register, or the Customs-free area of Gran Canaria).

# Chapter 2:

# Direct taxes on income or profits

# 2. Direct taxes on income or profits

In this section it is explained the most relevant issues concerning the main taxes levied on income obtained in Spain, both for corporations and individuals.

## *2.1 Corporate Income Tax*

The regulation of the Corporate Income Tax is contained in the Revised Text of the Corporate Income Tax Law, approved by Legislative Royal Decree 4/2004, of 5th March, and in the Regulations approved by Royal Decree 1777/2004, of 30th July, that is applied periodically, directly, and proportionally, to the income obtained by any corporation and other entities, to which the Law refers, which tax residency is located in Spanish territory.

Resident companies are taxed on their worldwide income. Taxable income includes all the profits from business activities, income from the regular business purpose, and income derived from transfer of assets.

The key factor in determining the application of corporate income tax is the "residence". A company is deemed to be resident in Spain for tax purposes if it meets any of the following conditions:

- That it was incorporated under Spanish law
- That its registered office is located in Spain
- That its effective management headquarters are in Spain

In order to establish the tax residence of a corporation or entity subject to the Corporate Income Tax in Spain, it will be necessary to apply the requirements appointed by the double taxation treaties subscribed by Spain.

### 2.1.1. Scheme of the tax liquidation

Through the subsequent paragraphs it is explained the main characteristics of this tax, in accordance with the scheme of liquidation:

| Commercial Code. New General Accounting Plan. |
|---|
| **Profit of the year** |
| (+/-) Adjustments<br>(+) Non deductible expenses<br>(-) Non-computable revenues<br>(-) Loss carryforwards<br>(-) Canary Islands investment reserve |
| **Taxable Base** |
| (x) Tax Rate (General: 30%; small and medium-sized companies: 20%-25%) |
| **Gross tax payable** |
| (-) Double taxation credits (internal and external)<br>(-) Tax benefits<br>(-) Other tax credits<br>(-) Witholdings, prepayments |
| **Net amount payable** |

In accordance with the tax liquidation scheme, and taking as starting point the accounting result of companies subject to and non exempt from the tax, it is necessary to establish the taxable base to which the tax rate will be applied.

The Corporate Income Tax Law establishes three methods for determining the taxable income:

- Direct assessment method
- Indirect assessment method
- Objective assessment method

Under the direct assessment method (which is generally applicable), taxable income is defined as the difference between revenues and expenses accrued during the fiscal year. Taxable income is based on the income disclosed in the financial statements adjusted in accordance with tax principles. Business expenses are deductible if they are properly recorded and supported.

## 2.1.2 Adjustments to the taxable base

- **Value adjustments: Depreciation**

Depreciation qualifies as a deductible expense only if it is effective and is recorded in the accounts.

There are official rate tables (updated by Royal Decree 1777/2004) which, if complied, relieve the company of the need to prove the effectiveness.

| Annual depreciation rate (%) | | |
|---|---|---|
| | Maximum | Minimum |
| Industrial buildings | 3 | 1,47 |
| Commercial buildings | 3 | 1 |
| Office furniture | 10 | 5 |
| Computers | 25 | 12,5 |
| Vehicles | 16 | 7,14 |
| Machinery | 12 | 5,5 |

Companies of certain kinds and in certain industries (e.g. small sized companies, mining companies, assets dedicated to R&D projects) may be authorized to depreciate their assets at their discretion in accordance with the special laws regulating each industry.

Intangible assets with a definite useful life may be amortized over ten years provided that the requirements established in the Law are met.

As a temporary measure for Fiscal Years 2013 and 2014, it has been established that the depreciation costs will be tax deductible only at 70percent (of the regularly deductible amounts), although the amounts not deduced by this temporary measure will be deductible since Fiscal Year 2015 in a 10 year period or during the lifespan of the asset, at the option of the taxpayer. This measure affects to the depreciation of fixed assets, real estate and intangible assets, and does not affect companies subject to the special regime for small sized companies, or to the taxpayers which have opted for a special depreciation plan.

On the other hand, it was established, as an exceptional measure in Fiscal Year 2012, the option to revalue at market value, certain assets, recording the increase in valor as an accounting reserve, and paying a flat rate of 5percent.

- **Non-deductible expenses.** The following expenses are qualified as non deductible:
    - Amounts directly or indirectly remunerating equity.
    - Corporate income tax.
    - Criminal and administrative fines and penalties, and surcharges for the late payment of taxes.

- Gambling losses.
- Donations and gifts.
- Provisions to internal pension allowances.
- Expenses for services relating to transactions performed directly or indirectly with individuals or entities resident in designated tax havens or paid through individuals or entities resident in tax havens, unless the payer can prove that the expense was incurred in a transaction effectively performed.

- **Provisions.** The following expenses are not deductible
  - Those resulting from implied or tacit obligations.
  - Those relating to compensation and other personnel benefits, except for the contributions to pension plans subject to certain requirements.
  - Those concerning the costs of complying with contracts which exceed the expected financial returns from them.
  - Those resulting from restructurings, unless they refer to legal or contractual obligations, not merely tacit obligations.
  - Those relating to the risk of sales returns.
  - Personnel expenses related to payments based on equity instruments, used as a form of employee compensation, either paid in cash or by awarding the instruments to employees.

- **Diminution in value of assets**

It refers to impairment losses made on account of the diminution in value of assets, computed at the end of the fiscal year, in order to adjust their value at market value.

- **Impairment losses on receivables for foreseeable bad debts** will only be tax deductible if any of the following circumstances happen:
  - The balance must be more than six months past due.
  - The debtor must have been held to be in insolvency.
  - The debtor must have been taken to court for the criminal act of dealing in assets to defraud creditors.
  - The obligations must have been claimed in court or the subject of a lawsuit or arbitration proceeding.

Nevertheless, losses to cover the risk of foreseeable bad debts from public entities cannot be deducted, unless the risk is related to the amount or existence of the credit, nor the losses to cover the risk of bad debts of related entities, unless the insolvency is declared by a Court of Justice.

- **Impairment losses related to equity securities** cannot be higher than the difference arising in the reporting year between the opening and closing balance of shareholders equity on the basis of either the accounts prepared by the directors or the accounts approved by the shareholders. This same criteria will be applied to companies of the group, multi-group or associated companies, although it will be corrected with the value of hidden capital gains and non deductible expenses in the subsidiary company.

Impairment losses relating to investments in entities resident in countries or territories deemed to be tax havens are not deductible unless those entities file consolidated financial statements with those of the entity that incurred the impairment loss, or when the said companies reside in the European Union.

In addition, impairment losses of equity which have a known repayment value and are not listed on regulated markets or are listed on regulated markets or are listed on regulated markets in countries or territories deemed to be tax havens are not deductible.

- **Market price valuation**. In certain cases, market valuation (i.e. valuation on an arm's-length basis) must be applied for tax purposes. This method is applicable to:
    - donated assets;
    - assets contributed to entities and the securities received in exchange;
    - assets transferred to shareholders in the event of dissolution, the withdrawal of shareholders, capital reductions with refund of contributions, paid-in surplus and the distribution of income;
    - assets transferred as a result of mergers an full or partial spin-offs;
    - assets acquired through swap transactions;
    - assets acquired as a result of exchanges or conversions.

It should be noted that current legislation provides for a special **tax neutrality** regime when some of the transactions described above are carried out as part of a corporate reorganization (i.e. mergers, spin-offs, non monetary contributions of business activities and share exchanges as well as non monetary contributions of assets if certain requirements are met). Under this regime, provided that certain requirements are met, the gains disclosed on the valuation market

prices of the assets and rights transferred may be excluded from the transferor's taxable base, and their taxation will be deferred.

One particular case, regarding the application of market value, is the valuation of operations made between related entities.

- **Transactions between related entities.** The Corporate Income Tax Law establishes that transactions between related entities will be valued at arm's-length value.

Hence, the Tax Authorities are entitled to verify that the valuation given to transactions performed between related entities is in accordance with arm's-length value and make the adjustments which it considers appropriate in relation to valuations which are not in accordance with the above-mentioned arm's-length value in relation to Corporate Income Tax.

Nevertheless, the corporate income tax legislation envisages the possibility that the taxpayer may submit to the tax authorities a proposal for the valuation of its transactions with related entities based on market conditions. If the proposal is approved by the tax authorities, such valuation is valid for tax purposes for a maximum period of four tax years.

In addition, Spanish regulations establish that the taxpayers are obliged to prepare certain documents regarding their operations with related parts, in which it is detailed, among other issues, the composition of the Group, a description of the transactions, the valuation criteria and the prices established. In this sense, there are thresholds under which the document obligations are not required (small sized companies whose amount of related transactions is below 100,000 €, with the exception of certain operations with tax havens). The procedures for valuation at arms' length are the standard ones for the OECD.

In this respect, for tax purposes the following are deemed to be related persons or entities:

- An entity and it shareholders.
- Entities and their directors.
- An entity and the spouses of, or persons related by direct or collateral consanguinity or affinity up to the third degree of kinship to, its shareholders or participants, board members or directors.
- Two entities belonging to a group.
- An entity and the shareholders or participants of another entity, where the two entities belong to a group.
- An entity and the board members or directors of another entity, where the two entities belong to a group.

- An entity and the spouses of, or persons related by direct or collateral consanguinity or affinity up to the third degree of kinship to, the shareholders or participants of another entity, where the two entities belong to a group.
- An entity and another entity in which the first-mentioned entity has an indirect holding of at least 25 percent of the capital stock or equity.
- Two entities in which the same shareholders, participants or their spouses, or persons related by direct or collateral consanguinity or affinity up to the third degree of kinship, have a direct or indirect holding of at least 25 percent in the capital stock or equity.
- An entity resident in Spain and its permanent establishments abroad.
- An entity not resident in Spain and its permanent establishments in Spain.
- Two entities that form part of a group taxed under the regime established for groups of cooperative entities.
- In cases where the relatedness is defined on the basis of the relationship between the shareholders or investors and an entity, the holding must be at least 5 percent, or 1 percent in the case of securities admitted to listing on a regulated market. The reference to "director" shall include de iure and de facto directors.
- There is a Group also when one entity holds or is able to hold the control or another entity under the criteria established in article 42 of the Commerce Code, with independence of the residency and the obligation to file consolidated annual report.

- **Thin capitalization rule – limits to the deductibility of financial expenses**

A a general rule, net financial expenses of a company are deductible with the limit of 30percent of the operative profits of each Fiscal Year. This limitation does not apply for the first million euro of net financial expense. The amounts non deductible in application of this rule might be applied in the subsequent 18 Fiscal Years. This limitation does not apply in certain cases, such as financial entities or insurance companies.

In addition, are also non deductible the financial expenses originated in debts with other companies of the Group, when the funds are used for the acquisition of equity of other entities of the same Group, or for the contribution in the capital of other companies of the same Group, unless it is proved the existence of valid economic motives.

- **Transactions performed with persons or entities residents in tax havens, and other transactions valued at market value**

As a general rule, the tax base must include the difference between the value per books and the normal market value of the assets which:

- Are owned by a resident entity that transfers its place of residence abroad, unless the assets remain assigned to a permanent establishment in Spain.
- Are allocated to a permanent establishment located in Spanish tax territory that ceases operations; or
- Having been previously allocated to a permanent establishment located in Spain, are transferred abroad.
- The tax authorities can value at market price any transactions with persons or entities resident in territories defined in the relevant regulations as tax havens if the valuation agreed upon has led to lower or deferred taxation in Spain. Furthermore, the entities or persons that make the transactions will be obliged to meet certain document obligations

- **Revenue and expense allocation criteria**

Revenue and expenses will the attributed in time to the fiscal year in which they are accrued, considering the real business activity developed, regardless of the moment in which the consideration is paid or financial arrangements are made, and observing the correlation due between expenses and income.

### 2.1.3 Exemptions and reductions

The Corporate Income Tax Law establishes the following exemptions and reductions:

- Exemption method to avoid international double taxation of the dividends or capital gains obtained in the transfer of shares of entities non resident in Spain.
- Exemption system applicable to certain income obtained from business activities developed abroad through a permanent establishment.
- Reduction in 50percent on revenues obtained from certain intangible assets.
- Furthermore, according to the "Cajas de Ahorros" (savings bank) Law, the total amount that these entities assign to finance non-profit projects will be also deductible.

### 2.1.4 Tax Loss carryforwards

Taxpayers of the Corporate Income Tax can carry forward its tax losses for offset against the taxable income of the following eighteen years, although there are limitations in case of

acquisition of inactive companies which held tax losses.

### 2.1.5 Tax rates

Spain's current standard corporate income tax rate is 30percent. Special rates are applicable to certain entities such as certain cooperatives (20percent) or entities engaging in oil and gas research and exploitation activities (35percent).

For small and medium-sized companies (companies whose turnover in the previous year falls below 10 million euro, considering for this all the companies of the same Group), in accordance to the Corporate Income Tax Law, the tax rate applicable to the first 300,000 € of taxable income is 25percent. Any taxable income above that amount is taxed at a 30percent rate.

Furthermore, with effect in Fiscal Years 2009, 2010, 2011, 2012 and 2013, the tax rate applied to small and medium-sized companies can be reduced from 25percent to 20percent, if the taxable base is between 0 euros and 120.202,41 euros, and from 30percent to 25percent for the taxable base that exceeds the said amounts, provided that the following requirements are met:

- The amount of net revenues of company is below 5 million euro.
- The workforce is below 25 employees.
- The company maintains or increases its workforce.

Finally, as an incentive for entrepreneurs, it has been established a reduced tax rate of 15percent for the first 300,000 € of the taxable base, paying 20percent for the amount in excess. This measure applies only to new companies during the first two years in which they obtain a positive income.

### 2.1.6 Tax credits

The gross tax payable can be reduced applying the following tax credits (as a general rule, as in the Canary Islands there are certain specialties explained later):

- **Tax credit for reinvestment of extraordinary income**

The income obtained in the transfer of certain assets, and included in the taxable base, will give the taxpayer the right to generate a tax credit to offset the gross tax payable of 12percent, on the condition that the consideration obtained is reinvested in the assets established by the Corporate Income Tax, and that the reinvestment is made within a period commencing one year before and ending three years after the date on which the asset transferred is made available, or exceptionally, following a special reinvestment plan proposed by the taxpayer and duly approved by the Tax Authorities.

- **Professional training tax credits**

A tax credit may be taken for 5percent of the amount of the employee training expenses.

This tax credit will be determined by multiplying the aforesaid percentage by the following coefficients:

  - 0.6 in the tax periods starting after 1st January, 2008
  - 0.4 in the tax periods starting after 1st January, 2009
  - 0.2 in the tax periods starting after 1st January, 2010

Nevertheless, this deduction was abolished partially for the tax periods starting after the 1st January of 2011, although it is maintained for Fiscal Years 2011, 2012 and 2013 the tax credit accrued on the expenses and investments made to train employees in the use of new information and communication technologies.

Except for the stated in the previous paragraph, from the 1st of January of 2013, the tax credit is fully abolished, although the tax credits accrued in previous years can be applied within the subsequent 15 fiscal years.

- **Tax Credits for Research and Development and technological innovation**

The tax credit base of this deduction will be the expenses incurred in the tax period on Research and Development (R&D) and technological innovation and, where appropriate, the investments in tangible and intangible assets, excluding buildings and lands.

The percentage of the tax credit will be 30percent, 50percent or 70percent, depending on the activity of R&D or technological innovation.

This tax credit is maintained in Fiscal Years 2012 and the following ones, and the amounts accrued for this concept in previous years can be applied within the subsequent 18 fiscal years.

- **Tax credits for the promotion of information and communication technology**

According to the Corporate Income Tax, a tax credit can generated up to 15percent of the amount of investments and expenses incurred in the fiscal year in order to improve the capacity of access and use of information in commercial transactions through Internet, as well as the improvement of internal procedures by using information and communication technology.

This tax credit will be determined by multiplying the aforesaid percentage by the following coefficients:

  - 0.6 in the tax periods starting after 1st January, 2008

- 0.4 in the tax periods starting after 1st January, 2009
- 0.2 in the tax periods starting after 1st January, 2010

This tax credit was fully abolished for the tax periods starting after 1st January, 2011, although the amounts accrued in previous years can be applied within the following 18 fiscal years.

- **Tax credits for export activities**

According to the Corporate Income Tax, a tax credit may be taken for 25percent of the amount of certain investments made in relation with export activities.

Nevertheless, the rate of the tax credit has been reduced, and in the following years will have the following evolution:

- 9percent in tax periods starting after the 1st January, 2008
- 6percent in tax periods starting after the 1st January, 2009
- 3percent in tax periods starting after the 1st January, 2010

Furthermore, this tax credit was fully abolished for the tax periods starting after 1st January, 2011, although the amounts accrued in previous years can be applied within the following 18 fiscal years.

- **Tax credits for environmental investments**

Investments made in fixed assets used for the protection of the environment consisting in installations that avoid air or acoustic pollution emanating from manufacturing installations, or water, sea, or underwater pollution, or the reduction, recovery or treatment of waste generated by the same company, can benefit from a tax credit for 8percent of the amounts destined to such ends, with the condition that the Authorities validate the tax credit.

Nevertheless, this tax credit was partially abolished for investments other that the ones mentioned above for the tax periods starting after 1st January, 2011, although the amounts accrued in previous years can be applied within the following 15 fiscal years.

- **Tax credit for investments in assets of cultural interest**

A 15percent tax credit could be taken for investments in assets of cultural interest, motion picture productions, publication of books, satellite vehicle navigation and location systems, adaptation of vehicles for disabled people and nurseries.

This tax credit was also reduced during the followings tax periods until its disappearance in 2011, 2012, and in some cases such as the investment in motion picture production productions, 2015. Nevertheless, the amounts accrued in previous years can be applied within

the following 15 fiscal years.

- **Tax credit for employer contributions to employment pension plans**

This tax credit encouraged contributions to employment pension plans or mutual entities which operate as employee welfare vehicles sponsored by the taxpayer for the benefit of workers whose annual gross salary is less than 27,000€ provided that such contributions are imputed. If the salary exceeds that amount, the tax credit will be taken on the proportion of the contributions which relate to 27,000€. The tax credit was equal to 10percent of the contributions made.

This tax credit will be determined by multiplying the aforesaid percentage by the following coefficients:

- 0.6 in the tax periods starting after 1st January, 2008
- 0.4 in the tax periods starting after 1st January, 2009
- 0.2 in the tax periods starting after 1st January, 2010

Nevertheless, this tax credit was abolished for the tax periods starting after 1st January, 2011, although the amounts accrued in previous years can be applied within the following 15 fiscal years.

- **Tax credit for hiring disabled workers**

A tax credit of 6,000€ per person/year will be granted, for the increase of the average workforce with disabled employees, with regard to the previous year. The contracts of these employees must be indefinite and full term.

This tax credit has not been abolished, and the amounts accrued in previous years can be applied within the following 15 fiscal years.

- **Tax credit for hiring workers by entrepreneurs (non disabled)**

A tax credit of 3,000 € can be accrued for the first indefinite term labour contract made by entrepreneurs, provided that the employee is younger than 30 years. Furthermore, companies with less than 50 employees than hire employees under the indefinite labour contract for entrepreneurs, will obtain a tax credit equal to 50percent of the unemployment subsidy pending of payment to the employee hired, with the limit of twelve salary months. As a general rule, these employees must be kept for three years.

This tax credit has not been abolished, and the amounts accrued in previous years can be applied within the following 15 fiscal years.

- **Tax credit for double taxation of dividends and on transfers of shares obtained from resident entities**

When the taxpayer has declared in its income dividends or sharing in profits of other entities that are tax resident in Spain, a 50percent tax credit will be applied on the gross tax payable related to the taxable base that includes the aforesaid dividends or sharing in profits.

The tax credit will have a 100percent rate when the resident company collecting the dividend owns at least 5percent of the resident company paying the dividend and had its holding during the 12 month period prior to the date on which the distributed dividend becomes claimable or, failing that, be maintained subsequently for the time required to complete that period.

- **Tax credit to avoid international double taxation**

In the cases in which the income obtained of a foreign source cannot be exempted from the taxable base, Spanish tax regulations provide for a tax credit to avoid the international double taxation. It is applied in two cases as explained below.

In the first place, when there is taxable income obtained in a foreign country, which as also been subject to taxation therein, it will be applied a tax credit for the lesser of two amounts: the effective amount paid in the foreign country for a tax which nature is identical or analogous to the Spanish one, or, alternatively, the amount of the tax that should be paid in Spain in case that the same income had been obtained in Spain.

In the second place, when the taxable base includes dividends or sharing in profits paid by an entity not resident in Spain, the tax effectively paid by the non-resident entity in respect of the income from which the dividends or shares in profits were paid will be deducted, on the condition that this amount is included in the taxable base of the taxpayer. To apply this tax credit, the shares must represent at least 5percent of the total equity, and the participation must be held at least one year, considering the period previous or subsequent to the date the income is obtained.

## 2.1.7 Special Tax Credits

The entities obtaining income from developing activities located in Ceuta or Melilla may be entitled to reduce a 50percent of those revenues from their gross tax payable.

On the other hand, it will be applicable a reduction up to 99percent for part of the gross tax payable corresponding with the revenues from exportation activities related to the Spanish film industry, books and other elements whose content will be normally standardized or edited with, as well as any edition with didactic character, provided that the benefits obtained are reinvested

within the same exercise in the acquisition of fixed assets used for these same activities, or in certain investments and expenses related to exert activities, environmental investments, assets of cultural interests, motion picture productions, book edition, navigation and localization systems for vehicles, vehicles adapted for disabled people, and daycare centres for employees' children.

This tax benefit will be abolished with effect 1st of January of 2014.

### 2.1.8 Withholdings and prepayments

Spanish companies are also required to make three tax instalments within the first twenty days of April, October and December in advance of the tax return current for that fiscal year.

Withholdings, prepayments on account and instalment payments made for the tax period shall be deducted from the resulting tax payable.

### 2.1.9 Special taxation regimes

## Consolidated taxation regime

Spanish tax law envisages the possibility of certain corporate groups being taxed on a consolidated basis. The filing of a consolidated return has significant advantages, most notably the fact that the losses of certain group companies can be offset against the profits of others, as well as the tax credits of individual companies against the tax quote consolidated, although meeting certain requirements.

From a tax point of view, a consolidated group is the one formed by a parent company, tax resident in Spain, that must be subject and not exempt to the Corporate Income Tax, or a permanent establishment in Spain of a non resident entity, and all the subsidiary companies, in which the parent company has an direct or indirect participation of at least 75percent. To apply for this tax regime, it is enough that the parent company or permanent establishment has at least a 75percent participation of other company at the beginning of the first tax period in which the regime is going to be applied, and such participation is maintained throughout the tax period.

## Spanish and European Economic Interest Groupings (EIGs)

These entities and their shareholders are subject to the general Corporate Income Tax rules, with some exceptions, among others:

- They do not pay corporate income tax on the portion of their taxable income attributable to

shareholders resident in Spain, and the EIGs can apply double taxation correction benefits.

- The non-resident shareholders of a Spanish EIGs are taxable under the Non-resident Income Tax Law and pursuant to the rules contained in the tax treaties. In particular, EIGs will only be subject to taxation if their activity gives way to the existence of a permanent establishment in Spain.

## Temporary Business Associations (UTEs)

These entities are taxed in the same way as EIGs, that is, attributing their taxable base to their partners; however, the foreign-source income derived from activities carried out abroad of UTEs through similar entities (joint ventures) can be exempt, if the taxpayer applies for it.

The losses obtained by a UTE abroad can be imputed to the tax bases of its members. If, in future years, the UTE obtains income it must be included in the tax base of its members up to the limit of the losses previously included.

## Foreign Securities Holding Entities (ETVE)

Current legislation of the regime governing foreign-securities holding entities (in Spanish, ETVE) is considered one of the most competitive in the European Union.

Entities will be able to apply for this regime if their corporate purpose includes the management and administration of nominative titles representing the equity of entities not resident in Spanish territory, by means of the appropriate organization of material and personal resources.

The dividends or shares in the profits of entities not resident in Spain, and income deriving from the transfer of the participation, can apply the exemption to avoid international double taxation, provided that certain requirements are met, being one of them that the participation in the non resident entity is at least 5percent.

## Neutral tax regime for mergers, spinoffs, contribution of assets, exchange of securities, and change of domicile of an European corporation or an European Cooperative corporation from one country of the European Union to another one of the European Union

This regime was established to facilitate corporate reorganizations (mergers, spinoffs, contributions of assets, and exchanges of securities). The Spanish tax system provides for a well-established special regime based on the principles of non-intervention by the tax authorities and tax neutrality, which guarantees the deferral of or exemption from taxation, as appropriate,

in respect of both direct and indirect taxation, for taxpayers carrying out such operations, along the same lines as the rest of the EU Member States.

According to such regime, in the case of mergers, the absorbing company can deduct for tax purposes up to a limit of one twentieth of the difference between the acquisition cost of a holding above the 5percent and its underlying book value that could not be allocated to the assets and rights acquired. The allocation of the difference to the rights and assets following the rules for preparing consolidated financial statements. As a temporary measure for Fiscal Years 2012 and 2013, the deductibility of goodwill depreciation has been reduced to 1percent.

In addition, the regime is based on the principles of subrogation and deferral in the taxation of capital gains, and the maintenance of tax values of the contributing entities and the assets contributed.

Finally, it must be borne that the regime establishes non-avoidance clauses, that require the existence of valid economic motives, in such a way that restructuring operations whose only or main purpose is obtaining a tax benefit cannot apply the special tax regime.

## Tax incentives for small and medium-sized companies

Companies whose net sales, in the previous year, amount to less than 10 million euros, calculated for the multinational group and including the family group of individual shareholders (in case of newly incorporated entities, it will be considered the current exercise), will qualify for certain tax incentives. The incentives can be summarized as follows:

- Accelerated depreciation of their tangible fixed assets up to certain limits, provided that certain job creation requirements are met.
- Accelerated depreciation of new fixed assets whose unit value does not exceed 601.01€ (up to an aggregate limit of 12,020.24€), without having to record the depreciation for accounting purposes. This tax credit is incompatible with the tax credit for reinvestment of extraordinary income.
- Entitlement to increase by a coefficient of 2 the maximum depreciation rates permitted per the official depreciation tables (without having to record it for accounting purposes) for new tangible fixed assets and intangible assets received in the fiscal year in which the company is entitled to apply the tax regime. Goodwill and trademarks can be depreciated by multiplying by 1.5 the maximum depreciation rates permitted per the official depreciation tables.
- Permission to record provisions for bad debts based on 1percent of the balance of their accounts receivable at the end of the tax period.

- The tax rate for these companies is 25percent, applicable to the first 300,000 € of taxable income. Any taxable income above that amount is taxed at 30percent.

## International "tax transparency" regime

This regime, according to which resident corporate income taxpayers shall include in their taxable base income obtained by its non-resident subsidiaries in Spain. In this respect, the tax regime applies when the taxpayer has obtained through a non resident entity, positive income which meets the following requirements:

- The taxpayer (Spanish company) holds 50percent or more of the capital stock, equity, voting rights or results of the non-resident company. Ownership interests held by relate entities or individuals (resident or non-resident) are included in determining such holding. Notwithstanding the above, this regime will not be applicable when the non-resident entity is tax resident of another EU Member State which is not deemed to be a tax haven according to Spanish legislation.
- The tax (corporate income tax or similar) paid by the non-resident on the attributable net income must be less than 75percent of that which would have been payable under Spanish regulations.

In addition, in order to attribute the positive income of the non resident entity, it is required that the income derives from any of the following sources:

- Ownership of real estate or rights in rem, unless such real estate is used for a business activity or licensed to another non-resident group company.
- Share in equity and transfer to third parties of capital. Nevertheless, the Law establishes certain exceptions, such as financial assets held in order to meet statutory requirements, as well as the financial assets that incorporate credits born in contracts that derive of the development of business activities, among others.
- Lending, financing, insurance and service activities, with the exception of services directly related to export activities made with related resident companies which incur deductible expenses. The attribution does not take place if more than 50percent of this type of income derives from transactions carried out with non related entities.
- Income deriving from transfers of assets or rights included in letters a) or b) above.

This legislation entitles the Spanish company to a tax credit on the amount of corporate income tax (or similar) actually paid by the non-resident entity and its subsidiaries as defined by law (in proportion to the net income attributed) and the tax actually paid as a result of the distribution

of dividends. The limit for this tax credit is the Spanish tax.

No tax credit is permitted for taxes paid in tax havens. Where the investee is resident in a country or territory classed as a tax haven it will be presumed that:

- The amount paid by the entity not resident in Spain attributable to any of the classes of income previously referred to in letters a) to d), in relation to a tax identical or similar to Corporate Income Tax, is lower than the 75percent of the one that would have been applicable in accordance with the corporate income tax rules.
- The income obtained by the investee arises from the mentioned classes of income.
- The income obtained by the investee is 15percent of the acquisition cost of the holding.

## Other special regimes

- Tonnage tax regime for ship companies
- Risk capital companies and funds and companies for industrial regional development
- Collective Investment entities
- Household renting companies
- Mining companies regime
- Sport entities regime
- Drilling and oil exploitation regime
- Special regime for certain financial lease contracts
- Listed companies dedicated to real estate market investments (SOCIMI)

### 2.1.10 Formal requirements

The tax period is the company's business year, and its financial statements and accounting records are the basic documentation to support its annual tax return.

The returns must be filed and the tax paid within the 25 days following the six months after the end of the tax period.

## *2.2 Personal income tax*

The Personal Income Tax, is a personal and direct tribute that taxes the worldwide income of

individuals that usually reside in Spain.

The following persons are subject to personal income tax:

- Individuals who are habitually resident in Spanish territory.
- Individuals of Spanish nationality who are habitually resident abroad and meet any of the requirements established in the Law (e.g. diplomatic and consular services, etc.).

Moreover, any Spanish national who establishes his residence for tax purposes in a tax haven will remain subject to personal income tax. This rule will apply in the year in which residence is changed and the subsequent four fiscal years.

A taxpayer is deemed to be habitually resident in Spanish territory if any one of the following conditions is met:

- The taxpayer is physically present in Spanish territory for more than 183 days in the calendar year. Sporadic absences are included in determining the length of time a taxpayer is present in Spanish territory, unless tax residence in another country is proved. In case of territories designated in the regulations as tax havens, the authorities may require the taxpayer to prove that he was present in the territory in question for 183 days in the calendar year (excluding absences due to cultural or humanitarian cooperation with the Spanish authorities).
- The main centre or base of the taxpayer's business or professional activities or economic interests is in Spain, either directly or indirectly.

In the absence of proof to the contrary, an individual is presumed to be resident in Spain if his/her wife/husband (from whom he/she is not legally separated) and dependent under-age children are habitually resident in Spain.

On the other hand, it is considered that the members of Spanish diplomatic missions or consular personnel, or other civil servants that develop their office in a foreign company, as well as their wife or husband (non separated) and their underage children, will retain their tax residency in Spain. Likewise, the same rule is applied with the due reciprocity to foreign diplomats, consular personnel, and civil servants that move to Spain for official reasons, unless an International Treaty establishes otherwise.

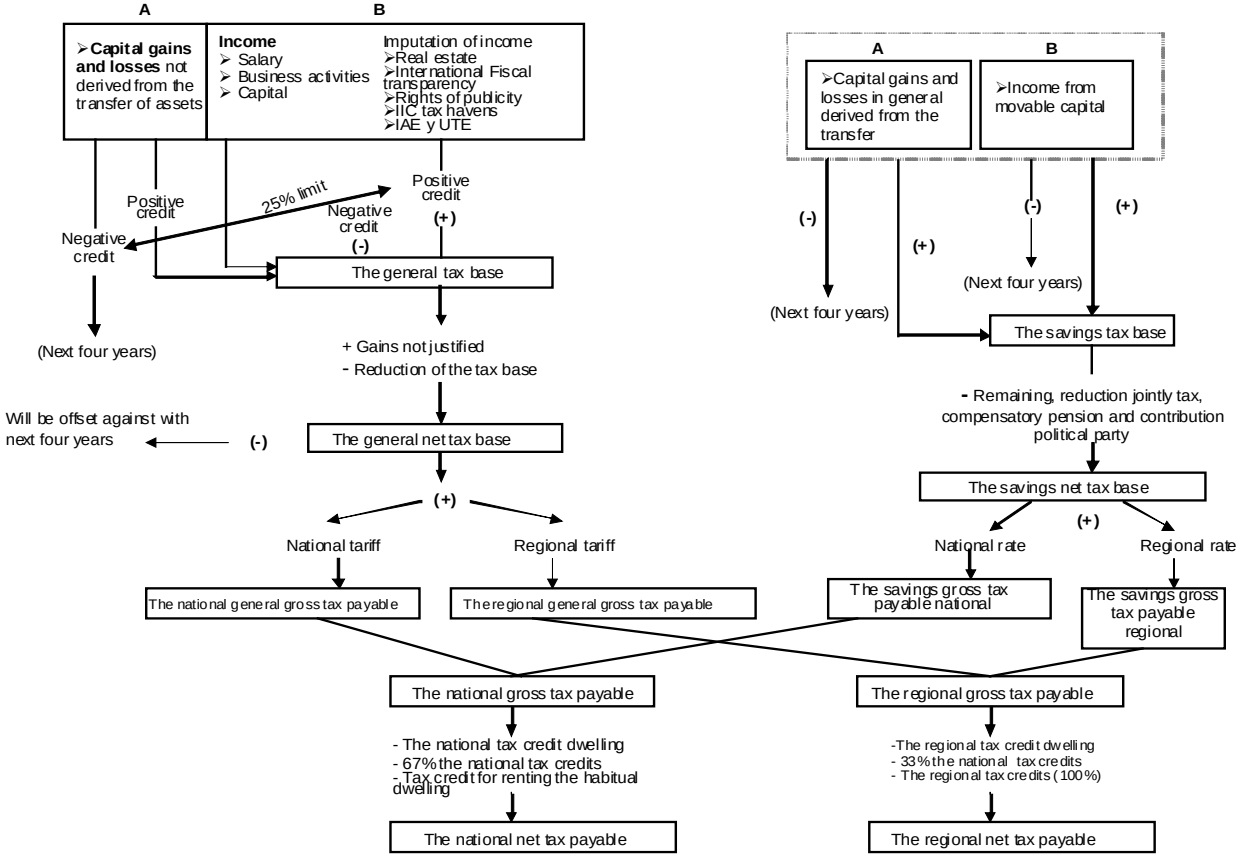
### 2.2.1 Tax structure and determination on the tax base

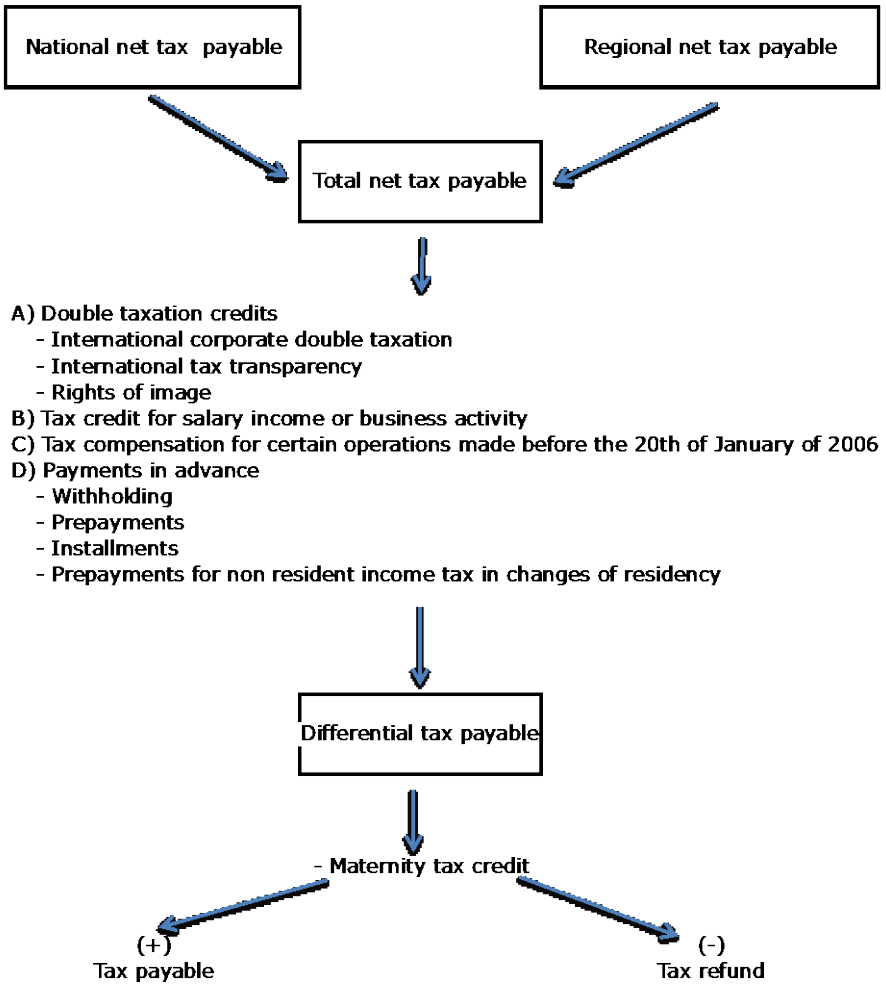
Taxpayers subject to this tax are taxed for their entire worldwide income, including the income of foreign entities in certain circumstances such us international tax transparency system,

unless the non-resident entity is resident of a EU Member State) as well as capital gains and losses incurred in the calendar year, net of the necessary expenses (as defined in the Law) incurred to obtain such income.

## General structure of the Income Personal Tax

The main particularities of this tribute are explained in the following diagram:






The following sources of income are considered taxable events:

- Salary income
- Income from movable capital
- Income from business activities
- Capital gains and capital losses
- Any other attributed income established by Law

The Law distinguishes between general income and savings income, and hence there is a general taxable base and a savings taxable base. The **general base** is the result of adding the following two balances:

- The balance resulting from adding and offsetting against each other, without limit, the

following income and attributions of income:

- Salary income.
- Income from real estate.
- Income from movable capital derived from the assignment of own funds to entities related to the taxpayer.
- Other income from movable capital which is not considered savings income, such as that derived from the assignment of the right to use the own image, that from intellectual property when the taxpayer is not the author and that from industrial property which is not attached to business activities performed by the taxpayer.
- Income from business activities.
- Attribution of income from real estate.
- Attribution of income from entities under the international tax transparency system.
- Attribution of income from assignment of rights or publicity over the own image.
- Changes in the value of units in collective investment entities established in tax havens.

- The positive balance resulting from adding and offsetting against each other, exclusively, capital gains and losses which are not derived from the transfer of assets, although since 2013, it will be included in the general taxable base the income obtained in the transfer of property, its improvements, preemptive rights, held for less than 1 year prior to the transfer of property. If this balance is negative, it may be offset against 25percent of the positive balance of income and attributions mentioned before. The rest of the negative balance will be offset in the following four years with the same limitations, the legislation establishing an express mandate to compensate the maximum amount that the rules allow.

The **savings taxable base** is formed by the positive balance resulting from adding the following balances:

- The positive balance resulting from adding and offsetting against each other, exclusively, the following:
  - Income derived from holding an interest in any type of entity.
  - Income from movable capital derived from the assignment of own funds to third entities not related to the taxpayer.

- The monetary return or payment in kind on capitalization transactions and life or disability insurance contracts.

If the inclusion and compensation of such income against each other leads to a negative result, this amount may only be offset against the positive balance of this income which is obtained in the following four years, and always the maximum limit allowed by the law must be offset.

- On the other hand, only the capital gains and losses which are classified as savings income will be included and offset against each other. If such result is negative, it may only be offset against positive balances of this type of income which are shown in the following four years, and only the maximum limit allowed by the law may be offset.

### 2.2.2 General Income

## Salary income

It is understood that the gross salary income is formed by any form of payment or utility, no matter its denomination or nature, monetary or in kind, that brings cause, directly or indirectly, from a personal work, labour o statutory relationship, not having either of them the consideration of a business activity.

One of the main permitted deductions from gross salary income to determine net salary income is social security contributions.

Furthermore, the assessment of the net salary income will include the following reductions:

- When the salary income has been generated over a period exceeding two years and, at the same time, the requirement that it has not been obtained on a periodic or recurring basis is met, or when the income is classified by regulations as irregular, a 40percent reduction will be applied with the limit of 300,000 €, although there are special rules for income derived from the exercise of stock options.
- A total of 2,652 Euros in general.
- For net income equal to or less than 9,180 Euros, the reduction will amount to 4,080 Euros annually.
- For net income between 9,180.01 and 13,260 Euros, the reduction will amount to 4,080 Euros less the result of multiplying by 0.35 the difference between the income obtained and 9,180 Euros.

The reductions mentioned above will be increased by 100percent in the case of:

- Active workers over 65 years who continue or prolong their labour activity, under the conditions which may be established by regulations.
- Unemployed persons registered in the Employment Office who accept a job which requires a change of their habitual residence to another municipality. This increase will be applied in the tax period in which the change of residence takes place and in subsequent periods.
- In addition, disabled persons may reduce their net income by 3,264 Euros annually (if they obtain salary income as active workers); this reduction will be 7,242 Euros when the need for the assistance of third parties is proven or in the case of persons with reduced mobility or with a degree of disability equal to or greater than 65percent.

Finally, the Law establishes an special regime for foreign workers that move to Spain as a consequence of a labour contract celebrated with an Spanish resident company to render services in Spain, by which the foreign worker can opt to apply the rules of the Non Resident Income Tax instead of the Personal Income Tax (that means lower tax rates). Among other requirements, it is required that the foreign individual has not been tax resident in Spain in the 10 year period previous to its moving, and that the salary does not exceed 600,000 € per year.

## Real estate income

It will be understood that the gross real estate income is formed by the sum of the income obtained from the ownership of rustic or real estate urban properties, any right or similar title on the properties, any other retribution obtained from the renting, constitution, cession of rights or faculties, no matter its denomination or nature.

In order to determine the net income all the expenses necessary to obtain the income can be deducted, as well as the depreciation of the property and the goods given in cession, as long as it correspond with an effective depreciation. If the expenses are higher than the income, the difference can be offset against a positive income obtained within the following four years.

In cases of lease of residential properties, a 50percent reduction will apply to the net income. The reduction is increased to 100percent for cases in which the lessees are aged between 18 and 35 and have a net salary income or income from business activities in the tax period exceeding the 'multiple purposes public indicator of income'.

In addition, if the income was generated over a period exceeding two years, or if it was obtained at irregular time intervals, a 40percent reduction will apply.

## Business activities

The income is considered obtained from a business activity when proceeding from capital and labour together, or from any one of such factors, means the disposition on the individuals' behalf of means of production, or human resources, or both, with the purpose of placing a product or service in the market.

However, it will not be considered as business activities income, those obtained through a company when the person carrying out the activities should register at a professional institution, or as a general rule, when the same activities are developed under a labour or dependent relationship.

Starting from 2013, there are new tax incentives for entrepreneurs. Thus, it has been established a 20percent reduction in the net income obtained by an individual business activity during the first two years in which the individual obtains a positive net income. Furthermore, it will be fully exempted (until now the exemption only covered 15,500 €) the perception of the unemployment aid as an unique payment dedicated to the setup of a new business activity.

## Income from movable capital

All the income, monetary or in kind, obtained from movable capital or goods or rights, not classified as real estate and that are not affected to a business activity.

Attending to its origin, income from movable capital can be classified in one of the following groups:

- Income derived from an interest hold in any type of entity
- Income from movable capital derived from the assignment of own funds to third entities
- The monetary return or payment in kind on capitalization transactions and life or disability insurance contracts
- Other income from movable capital, which include, among others, the ones deriving from intellectual or copyright property, lease of movable property, lease of businesses or mining industries, provided that any of them are not considered business income.

## Capital gains and losses

A capital gain or loss will be constituted by the variation of values in the personal assets of the taxpayer that may arise as a consequence of an alteration in its composition, as long as it is not caused by a transfer of property.

## Attribution of income

The Personal Income Tax Law establishes certain special regimes that will be integrated in the general base according to their own regulation. These special regimes are the following:

- Attribution of real estate income
- International tax transparency
- Cession of image rights
- Collective investment institutions
- Attribution of income originated in Economic Interest Groupings and Temporary Business Associations

### 2.2.3 Savings income

This income has the following typology:

## Income from movable capital

The following incomes are considered movable capitals computed as savings income:

- Participation in equity of entities
- Assignment of own funds to third parties
- Capitalization transactions
- Life or disability insurance contracts
- Imposition of capitals that originate an income

## Capital gains and losses deriving from transfer of property

A capital gain or loss will be constituted by the variation of value in the personal assets of the taxpayer that may arise as a consequence of the alteration in its composition, as long as it is originated by a transfer of property and they are not considered general income.

In this respect, the capital gain or loss will be determined usually the following way:

- Valuation. In the case of a monetary transaction, the difference between the acquisition values and the transmission values of the goods.
- Adjustment coefficients. The Law does envisage the application of adjustment coefficients only for real estate assets. The adjustment coefficients are aimed at correcting the inflation

effect and are applied to the acquisition cost of the transferred real estate and to the related depreciation.

- Capital gains on assets acquired before the 31st of December of 1994. The Law establishes a transitory regime for the gradual reduction of the taxable capital gain in assets acquired before the 31st of December of 1994, for the fraction of the gain that was generated proportionally before the 19th of January of 2006.
- Other exemptions. Capital gains on the donation of family business are tax exempt provided that the assets used by the donor in the business activity its acquisition have remained assigned to such business activity for at least five years prior to the transfer date. For this exemption to apply the following additional requirements must be met:
    - The transferor must have be least 65 years, or suffer from absolute permanent disability or great disability.
    - If the transferor was carrying out managing functions in relation with the family business he shall cease in such functions and must not be remunerated from the moment the transfer takes place.
    - The recipient must keep the assets received for at least 10 years as of the date of the public deed documenting the transaction, unless decease, and cannot carry out acts or transactions which could lead to a significant decrease in the acquisition value of the business received.

Furthermore, capital gains obtained on the transfer of or shares or participations held in collective investment institutions will be exempt, provided that the amount obtained is reinvested in assets of a similar nature. The new shares or participations subscribed will maintain the value and his acquisition date of the shares or participations transferred, if, in the year prior to the transfer, the transferor's ownership interest in the collective investment institution has not exceeded 5percent, and the number of the entity's shareholders exceeds 500.

Finally, it will also be exempt from taxation the capital gain obtained in the transfer of the principal residence of individual older than 65 years or which are in a situation of severe dependency or great dependency.

### 2.2.4 Net taxable base

The Law distinguishes between the net general taxable base and the net savings taxable base. The net general taxable base will be the result of applying the following reductions to the general taxable base.

## Reductions to the general taxable base

- Reductions for contribution to pension funds.
- Reduction for contributions to mutual funds and social pension plans.
- Reduction for contributions to guaranteed prevision plans.
- Contributions made directly by employees to social prevision business plans.
- Insurance cost for policies that cover exclusively situations of severe dependency or great dependency.
- Reductions for compensatory pensions.

The overall maximum amount of the employer's contributions to any type of social pension plan is the lowest of the following ones:

- 30percent of the sum of net salary income and net income from business activities, with the possibility of a 50percent increase for employees aged over 50.
- 10,000€ per year. Nevertheless, the amount will be 12,500€ for employees aged over 50, and the limit for insurance cost that cover exclusively situations of severe dependency or great dependency will be 5,000 € per year.

Furthermore, there are increased limits for the contributions to social protection plans or protected assets for disabled persons that go from 10,000 € to 24,250 € per year.

## Reductions in the taxable base

The taxpayer can reduce in a period of time of five years from its general tax base the amounts for the contributions invested, in case of insufficiency of the general tax base or due to the application of the percentage limit (30percent-50percent). This rule will not be applicable to those contributions that exceed the total limit established in the Laws that regulate mutual and pension plans, neither in those cases in which exceed the total limit established in the financial regulation of the Mutual and Pension Plans Law.

There exists the possibility of applying the reduction for those contributions to social systems in which the taxpayer's wife or husband is the holder, participant o mutualist, as long as the wife or husband does not obtain a salary income or business activities income, or if obtained at all it is lower than 8,000 Euros per year. The reduction limit is 2,000 Euros, and such contributions are not subject to inheritance or gift tax.

The net savings taxable base will be the result of subtracting from the savings taxable base the

remnant not assigned to the general taxable base of reductions concerning compensatory pensions and contributions to politic parties. The resulting balance can never be negative.

## Reductions in the net taxable base to adapt the tax to the personal and family situation of the taxpayer

The Personal Income Tax Law tries to adapt to the personal and family situation of the taxpayer, which translates into the so called personal and family minimums, which are defined as the amounts of the income that the taxpayer assigns to its personal and family basic needs, and which is exempt from the IRPF. The amounts detailed below can be modified by the regional governments.

- **Taxpayer's minimum**

As a general rule, the reduction amounts to 5,155€ Euros per year. If the taxpayer's age exceeds 65 years, the minimum will be increased by 918€ Euros per year, and if the age exceeds 75 years, the minimum will be increased in 1,122€ Euros per year.

- **Minimum for descendants**

The minimum for descendants will be, for each descendant aged under 25, or disabled descendants regardless of age, living with the taxpayer and not obtaining annual non exempt income above 8,000€, a reduction of 1,836€ for the first, 2,040€ for the second, 3,672€ for the third and 4,182€ for the fourth and subsequent ones. Where the descendant is aged under 3 years, the amounts will be increased by 2,244€ per year.

- **Minimum for ancestors**

The minimum for ancestors will be of 918€ for each one whose age is over 65 years or, disabled persons that lives with the taxpayer that does not obtain income in the year exceeding 8,000 Euros.

Furthermore, it will be understood that the ancestors are living with the taxpayers, when, depending on the taxpayers, are taken into a specialized care centre. If the ancestors is over 75 years the minimum is increased by 1,122€ per year.

- **Minimum for disability**
    - The minimum for the disability of the taxpayer will be 2,316€ per year, although it will be 7,038€ for disabled persons who prove a disability equal to or greater than 65percent. There will be an increase of 2,316€ per year for care expenses, if the need for assistance of third parties, limited mobility or a disability of at least

65percent is proven.

- The minimum for disability of ancestors or descendants will be 2,316€ for each one of the descendant or ancestors that give right to the minimum as explained above, although it will be 7,038€ per year for disabled persons who prove a disability equal to or greater than 65percent. The minimum will be increased by 2,316€ per year for care expenses for each person in which the need for assistance of third parties, limited mobility or a disability of at least 65percent is proven.

### 2.3.5 Determination of the gross tax payable: tax rates

The gross tax payable (national and of the autonomous communities, or regional), with regard to the amount of the net taxable base that exceeds personal and family minimums, is calculated applying a progressive scale, both for the national and the autonomous community taxable bases.

For fiscal years 2012 and 2013 it has been established an supplementary rate for both general and special scales. The following tables reflect the increased tax rates for fiscal years 2012 and 2013.

The following tax scales do not vary on the basis of the type of return (joint or separate) chosen by the taxpayer:

| General Table | | | |
|---|---|---|---|
| **Tax base** | **Gross Tax Payable** | **Remainder of Tax Base** | **Tax base** |
| **Up to Euros** | **Euros** | **Up to Euros** | **Percent** |
| 0 | 0 | 17,707.20 | 12.75 |
| 17,707.20 | 2,257.66 | 15,300 | 16.00 |
| 33,007.20 | 4,705.66 | 20,400 | 21.50 |
| 53,407.20 | 9,091.66 | 66,593.00 | 25.50 |
| 120,000.20 | 26,072.88 | 55,000.00 | 27.50 |
| 175,000.20 | 41,197.88 | 125,000.00 | 29.50 |
| 300,000.20 | 61,622.88 | Hereinafter | 30.50 |

| Autonous Community Table for the Canary Islands | | | |
|---|---|---|---|
| **Tax Base** | **Gross Tax Payable** | **Remainder of Tax Base** | **Tax Rate** |
| Up to euros | Euros | Up to Euros | Percent |
| 0 | 0 | 17,707.20 | 12.00 |
| 17,707.20 | 2,124.86 | 15,300 | 14.00 |
| 33,007.20 | 4,266.86 | 20,400 | 18.50 |
| 53,407.20 | 8,040.86 | Hereinafter | 22.58 |

To sum it up, the aggregated tax rate will be between 24.75percent and a maximum of 53.08percent.

The net savings taxable base, without considering the personal and family minimum, will be taxed as follows:

For the first 6.000,00 euros : at a fixed rate of 21percent.

For the amount that exceeds or equals 6.000,01 euros up to 24,000 €: at a fixed rate of 25percent.

For the amount that exceeds or equals 24,000.01 €, at a fixed rate of 27percent.

The sum of the amounts resulting from applying the national and autonomous tax rates to the general tax base and to the savings tax base as described will determine the national and autonomous community gross tax payable respectively.

### 2.3.6 Net tax payable and differential tax payable: Tax credits

The national net tax payable will be calculated, subtracting from the national gross tax quote the sum of the following tax credits:

- Tax credit for acquiring a house for home use. A tax credit of 10.5percent of the amount invested in acquiring or refurbishing the taxpayer's principal home may be generated; applied to the investment made, purchase expenses and the interest and expenses paid on loans contracted, and the amounts deposited in home-purchase saving accounts and used for the acquisition of the habitual home. The maximum deduction per year is 9,015 Euros. This tax credit has been abolished since the 1st of January of 2013, although there is a transitory regime by which the deduction will be applied to houses purchased before the

aforesaid date, and in the cases of taxpayers that had started the reforms for the restoration or enlargement of their principal home, or disabled people that had started reformation works to adapt the house to their condition.

- 50percent of the tax credits for business activities, donations (there is a 25percent tax credit for the donation made in favour of certain entities), income obtained in Ceuta y Melilla, measures to protect and spread the knowledge of Historical Spanish Wealth (and of the cities, group and goods declared World Wealth). Deduction of the 15percent of the amount invested and expenses incurred in cultural goods and business savings-accounts.
- Tax credit for renting a house for home use. A tax credit of 10.5percent of the amounts paid by taxpayers during the current period for renting houses for home use, as long as the taxable base of the taxpayer is lower than 24,107,20 Euros that fiscal year. The base of the deduction is proportional to the taxable base, in such a way that the deduction base is 9.040 € if the taxable base is equal or lower to 17.707,20 €, and is reduced progressively till zero for a taxable base of 24.107,20 €.
- The autonomous community net tax payable will result from decreasing from the gross autonomous community tax payable the amount corresponding to the tax credit for acquiring a house for home use. (4.95percent) and the remaining 50percent corresponding to the tax credits mentioned above (with the exception of the tax credit for renting houses for home use.

Likewise, the Autonomous Communities are entitled to establish certain tax credits in their respective territories. In the case of the Canary Islands, the following minor tax credits have been approved:

- Personal or family circumstances of the taxpayer (birth or adoption, nursery expenses, expenses corresponding to descendants studying out of home, disabled taxpayers or taxpayers older than 65 years, or big families).
- Relative to home investments: acquiring or renting, and for the variation of the euribor rate.
- For donations made for the acquisition of the first house for home use, donations for ecologic purpose or for the conservation of the National Wealth.
- For change of residence to another island because of labour reasons, as well as those amounts paid by the taxpayers to repair or reform real estate goods classified of cultural interest.
- The differential tax payable will be the result of decreasing from the total net tax payable (national and autonomous community) the sum of the tax credits for international double

taxation, tax credits originated on the underlying tax corresponding to attribution of rents deriving from the international tax transparency or cession of image rights, withholdings, and tax prepayments.

Likewise, it is also possible to apply the maternity tax credit, with the limit of 1,200€ per year, and the tax credit for employment or development of business activities, which varies from 0 to 400 euros per year, and can be solely applied if the taxable base is equal or lower than 12.000 euros.

### 2.3.7 Withholdings

Payments of income from movable capital, gains on shares or participations in collective investment institutions, salary income, among others, are subject to withholding in advance of the tax finally accrued.

Furthermore, employers are obliged to make personal income tax prepayments in respect of compensation–in-kind paid to their employees.

To calculate the withholding tax applicable to salary income, the deductible expenses and reductions and the personal and family minimums for descendants are deducted from the total amount of such income, obtaining this way an amount similar to the net taxable base. The tax scale (aggregate of national and Autonomous Community rates) is applied to this amount to obtain the amount of withholding. The applicable withholding tax rate is obtained by dividing the amount of withholding by the total income. The following table shows the most relevant taxable base and withholding rates for the main sources of income valid for fiscal year 2013. It must be noted that it is expected that since 2014 there will be a 2percent reduction in rates:

| The Base, Rate or withholding and prepayment for the main types of income | | | |
|---|---|---|---|
| | **Income** | **Base** | **Rate** |
| **Salary Income** | General | Total amount of compensation paid | Table |
| | Contracts lasting less than one year | | Minimum 2% |
| | Special dependent employment relationships | | Minimum 15% |
| | Board of Directors members | | 42% |
| | Courses, talks, assignment of literacy, artistic or scientific works | | 21% |
| **Income from movable capital** | General | Full consideration claimable or paid | 21% |
| **Professional activities** | General | Amount of revenues or consideration obtained | 21% |
| | Commencement of activity and subsequent two years (pending the implementing regulations) | | 9% |
| **Capital gains** | Transfer sor reimbursements of shares and participations in collective investment schemes | Amount to be included in the tax base, calculated according to the PIT Regulations | 21% |
| | Cash prices | Amount of revenues or consideration obtained in the tax base | 21% |
| **Other income** | Lease/sublease of urban property | Amount of rent and other items paid to the lessor or sublessor VAT | 21% |
| | Intellectual and industrial property lease/sublease of movable property and business | Full amounts paid | 21% |
| | Licensing of rights of publicity | Full amounts paid | 24% |

## *2.3 Tax Benefits in Direct taxation specific to the Canary Islands*

### 2.3.1 The Reserve for Investments in the Canary Islands

This tax benefit intends to promote investments in the Canary Islands which, for companies, have effects over the taxable base, whereas for individuals developing a business activity has effects on the tax payable. It is in force since 1994, and has endured several reforms and

amendments, the last one being its prorogation for the period 2007-2013, and it is expected that during 2013 it will be known the term for the prorogation of the regime for the period 2014-2020.

## Scope of the tax benefit

The Reserve for Investments in the Canary Islands (hereinafter, RIC), can be applied by the entities subject to the Corporate Income Tax (IS), in case they have an establishment in the Canary Islands, as well as by individuals that determine their net income by the method of direct appreciation, provided that he income derives from economic activities developed through establishments located in the Archipelago, and that the accounting rules of the Code of Commerce are observed.

The RIC can also be applied by individuals and entities non resident in Spain that operate in the Canary Islands through a permanent establishment, for the income obtained, through a reduction in the taxable base of the Non Residents Income Tax.

On the other hand, companies whose main business activity consists in financial services or rendering services to other related companies of its same group, will be able to make RIC allocations, on the condition that they are solely assigned to the financing of initial investments. Nevertheless, profits resulting from business activities concerning ship building, synthetic fibres, automotive industry, coal and steel industry cannot benefit from the RIC regime. Furthermore, RIC allocations must observe the restrictions established by certain European Community regulations on agricultural, forest, fisheries, aquaculture, and transport activities.

## Contents of the tax regime

With effects for fiscal years starting after the 1st of January of 2007, with respect to the application of the benefit to companies or individuals, we can distinguish:

**A) Companies**. Companies can benefit from a reduction in the taxable base of the CIT for the amount of the RIC allocations made each fiscal year, or tax period. The allocation has a limit of 90percent of the profits of the fiscal year that have not been distributed and correspond to the establishments located in the Archipelago.

In this respect, the following rules must be observed:

- The reduction cannot produce in any case a negative taxable base.
- It will be considered that the profits that proceed from establishments in the Canaries are the ones that derive from operations developed with human and material resources

assigned to the operations, which close a mercantile cycle that produces an economic result.

It will be considered non distributed profits the ones assigned to engross the reserves of the company, with the exception of the legal reserve. Furthermore, neither will be considered non distributed profits the following ones:

- Income on which the tax credit for reinvestment of extraordinary profits has been applied.
- Income that derives from the transfer of assets whose acquisition had been used for the investment of RIC allocated with profits obtained in fiscal years started after the 1st January of 2007.
- Income that derives from the sale of fixed assets which have not been assigned to an economic activity, being considered as such the assets that represent a participation in the capital of another entity and the cession to third parties of financial resources.

If the company disposes of its equity in the same fiscal year in which the reduction of the taxable base due to RIC allocation takes place, it is understood that the RIC allocation is reduced in the amount of the equity disposed of. The same reduction might be applied in the fiscal year in which the Shareholders meeting adopt the agreement by which the RIC is allocated (that is, the fiscal year following the one in which the profit was obtained).

On the other hand, RIC allocations can be considered in Corporate Income Tax instalments. When the instalments are made through the method of taxable base, the taxable base can be reduced in the amount in which the RIC is expected to be allocated into each one of the periods that comprehend three, nine or eleven months of the fiscal year, with the limit of 90percent of the taxable base into each one of the periods mentioned. Notwithstanding that, if the RIC finally allocated (in the definitive Corporate Income Tax) is lower than 20percent of the amount of the reduction made in the instalments projected to one year base, the company will be obliged to regularize its instalments by the difference between the initial forecast and the effective allocation, plus late payment interests and surcharges that might apply.

**B) Individuals**. In this case, the tax benefit consists in a tax credit against the gross tax payable of the Personal Income Tax for the net income obtained and assigned to RIC, which must proceed from a business activity developed in the Archipelago, through an establishment located therein.

The tax credit is calculated applying the average tax rate to the annual allocation of the reserve, with the limit of 80percent of the gross tax payable which corresponds proportionally to the net income mentioned before.

We offer below an example comparing the taxation in the Corporate Income Tax of a company

that applies RIC against a company that applies the general rules of taxation for the rest of Spain:

> *Example: One company that develops its business activities in the Canary Islands, obtains a profit after taxes of 900,000€. This profit was generated partially through the realization of business activities in the Canary Islands (800,000€), and the rest (100,000€) is due to various financial investments. Furthermore, the company has an amount of 200,000€ of tax loss carry forward (TLFC) pending of compensation, and it is not expected any other adjustment to the taxable base besides the RIC. In the following table the tax payable is calculated and it is compared against the tax payable obtained by a company that does not develop any activity in the Canary Islands and hence cannot apply the RIC benefit:*

| **Example comparing the taxation in the Corporate Income Tax of a company that applies RIC against a company that applies the general rules of taxation for the rest of Spain** | | | |
|---|---|---|---|
| **Company operating in the Canaries (applies RIC)** | | **Company operating outside the Canarias (without RIC)** | |
| Profit after taxes<br>Profit that qualifies for RIC allocation<br>Adjustment in the table base for RIC (90% of the profit that qualifies for RIC)<br><br>Taxable base with RIC reduction | 900,000<br>800,000<br><br>-720,000 | Profit after taxes<br><br><br><br><br>Taxable base without RIC reduction | 900,000 |
| Profit after taxes<br>RIC Adjustment<br>TLCF compensation | 900,000<br>-720,000<br>-180,000 | Profit after taxes<br>TCLF compensation | 900,000<br>-200,000 |
| Taxable base<br>Gross tax payable (30%) | 0<br>0 | Taxable base<br>Gross tax payable 30% | 700,000<br>210,000 |
| Final tax payable<br>**RIC tax saving** | 0<br>**210,000** | Final tax payable | 210,000 |

## Investment of the RIC allocation

The amounts allocated to the RIC must be materialized (invested) in any of the following:

*Initial investments*

a) Acquisition of new assets, corporal or intangible as a consequence of the creation or enlargement of an establishment, the diversification of the activity of an establishment for the manufacturing of new products, or a substantial transformation in the manufacturing process of an establishment.

It will also be considered initial investments the purchase of land, built up or not, which has not taken previously advantage of this regime, and is assigned to one of the following activities:

- Promotion of government-protected housing.
- Development of industrial activities included in Divisions 1 to 4 of the first section of the tariffs of the Tax on Economic Activities.
- Shopping centres and tourist activities whose acquisition has the purpose of refurbishing the decaying tourist industry.

If the investment consist in means of transportation, they must be assigned to the internal services of the business developed in the Canary Islands, and cannot be used to give services to third parties.

As for intangible assets, the investments can only consist in rights to use or intellectual or industrial property, non patented knowledge, administrative concessions, which meet the following requirements: are used solely in a establishment that meets the requirements mentioned previously, must be an asset subject to depreciation, must have been acquired to third parties at market value, and must be recorded as a fixed asset in the accounting books. Intangible assets will only give right to a RIC investment for 50percent of their value, unless it is a reduced-size company.

b) Job creation, insofar it is related directly to initial investments. It is necessary that the hiring happens in the period that comprehends the six months prior to the date in which the investment entered into work and the following six months.

c) Subscription of shares issued by other companies as a consequence of its incorporation or a capital increase, that develop in the Archipelago its activity, provided that certain requirements are met, namely, the execution of some of the investments mentioned before in letters a) or b). These investments must be executed in the same period that was left to the company that subscribed the capital in order to invest its RIC.

*Investments that are considered working aid*

- Acquisition of fixed assets, corporal or intangible, which do not meet the requirements to be

considered an initial investment. There are also relevant limitations regarding the purchase of land.

- Acquisition of assets that contribute to improve and protect the natural environment in the Canary territory, as well as the investments assigned to the exploitation of renewable energy sources for its transformation into electricity.
- Research and Development expenses.
- Subscription of shares issued by entities of the Special Canary Zone (ZEC), as a consequence of their incorporation or capital increase, although the following additional requirements must be met:
    a) The amount of the capital incorporated or increased must be at least 750,000€.
    b) At least 10percent of the capital must be subscribed by a corporation or individual that makes the investment for purposes other than RIC investment.
    c) The ZEC entity must make one of the initial investments mentioned (letters a and b)
- Subscription of shares or participation on the capital or the equity issued by risk capital companies or funds, as well as investment funds. The subscription must be made at the moment of the incorporation or capital increase, and the amount invested must be used by the risk capital company in the subscription of capital issued or in a capital increase of other companies that, in their turn, execute the investments qualified as initial investments (letters a and b).
- Subscription of equity or account annotations of public bonds of the Canary Islands Autonomous Community, of the local corporations of the Canary Islands, or their public companies or autonomous bodies, provided that the public debt is assigned to the financing of investments in infrastructures, or the improvement and protection of the natural environment in the Canary territory.
- Subscription of equity issued by public entities pursuant to the building or exploitation of infrastructures or equipment that are of public interest for the Public Administrations in the Canaries, when the financing obtained is assigned solely to the construction or exploitation mentioned.
- Subscription of equity issued by private entities pursuant to the building or exploitation of infrastructures or equipment that are of public interest for the Public Administrations in the Canaries, once the due concession or administrative authorization is obtained, when the

financing obtained is assigned solely to the construction or exploitation mentioned.

The last three investments will have a joint limit of 50percent of the RIC allocated each year.

## Localization and use of the assets

The assets that have been assigned to RIC investment must be located or being received in the Canary Islands, must be used therein, assigned and needed for the development of economic activities of the taxpayers, unless they contribute to the improvement and protection of the natural environment in the Canary territory.

## Period to invest the reserve

The investment of the amounts allocated to RIC must be executed within a 3 year period, starting from the due date of the tax corresponding to the fiscal year in which the Reserve has been allocated. This implies in fact an effective period of five years: the fiscal year in which the profit is obtained, the one in which the RIC is allocated and the taxable base is reduced, and the three following ones. It is understood that the investment is executed when the assets are put to work, even in the case of financial leasing contracts.

## Period of maintenance of the investments

Assets that are considered valid investments must be kept in use in the company during at least 5 years, without being transferred, leased or lent to others. When their working life is shorter, they must be replaced by other assets, which must also meet RIC requirements, and which must be kept in work during the time needed to complete the 5 year requirement. In case of investment in land, the period of maintenance will be 10 years.

It will we understood that this new acquisition is not a valid investment of RIC compromises, except for the amount of its value that exceeds the value of the asset being replaced and which was assigned initially to RIC materialization.

In the case of land, the period of maintenance will last ten years.

## RIC recording in the accounting books

RIC allocations must figure in the balance sheet of the company duly separated and under an appropriate title, and it cannot be disposed of, or distributed, as long as the assets in which it was invested must remain in the company.

## Investment plan

The RIC benefit requires that the taxpayers file an investment plan electronically using the form offered by the Tax Agency web page, in which the following information must be provided:

- The purpose of the activity to which the investment is assigned.
- Whether it is an initial investment or not.
- Description of the asset to be acquired, with an estimation of the purchase price, and the date in which is the asset is expected to start working.
- Description of the job creation or the modifications in the staff that might happen as a consequence of the investment.
- In any case, it must be described any anticipated investments that had been made.

If the investment finally made differs to the one planned, or if there is a delay in the date in which the asset is expected to start working, an amendment of the plan must be filed.

## Anticipated investments

Investments made in the three years prior to the one in which the RIC is allocated, or to the year in which is obtained the profit upon which the RIC allocation is going to take place, can be considered as valid RIC materializations, provided that the profits have been generated before the 31st December of 2013.

The year in which the investment is made must be communicated, along with certain financial information, jointly with the tax return of the Corporate Income Tax, Personal Income Tax or Non Residents Income Tax.

## Acquisition of investments through a financial lease contract

RIC investments can be financed through a financial lease contract, on the condition that the purchase option is effectively exercised.

## Other issues

- Determination of the amount of the investment

RIC investment is deemed to be executed by the acquisition purchase or cost of producing the assets, with the exclusion of interests, indirect taxes levied by the State, and surcharges, and can never be higher that its market value.

In the case of equity, the investment includes the amount paid at the moment of the subscription, as well as the issue premium.

If some part of the investment is financed with subsidies, it will not be considered as a valid investment.

- Formal requirements

As a consequence of the allocation of RIC, companies are required to show the following information in their Annual Report:

  - Amount of the RIC allocation and the fiscal year in which they were made.
  - RIC amount whose investment is pending, and its age.
  - Amount and date of the investments, including the ones anticipated, with reference to other aids, being them of tax nature or not, which had been received in relation with each investment.

This information must be shown in the Annual Report of the company throughout the whole period of maintenance of the assets in which the RIC is materialized. When the taxpayer has not an obligation to file Annual Reports, this information must be recorded in an accounting book named register of investment assets. In the case of indirect investments, the requirement reaches the company that assumes the obligation to make the investment.

## Incompatibilities of the regime

Apart from the incompatibility with certain State Aids, the RIC tax benefit is incompatible, for the same assets and expenses, with the deductions to promote the development of certain activities, regulated in the Corporate Income Tax Law, Chapter IV of Title VI, and with the tax credit for investment in new assets regulated in Law 20/1991.

## Quantitative limits to the tax benefit for RIC allocations

Following the regulations of European Community Law, State aids of regional purpose cannot exceed certain limits in the percentage of the investment that is financed by the aids; in the case of ultra-peripheral regions, like the Canary Islands, 40percent, percentage that increases to 50percent for medium sized companies and 60percent for small companies. These limits are applied considering not only the savings in the tax payable due to RIC, but any other aid (for example, subsidies).

## Consequences of the non-fulfillment of the requirements

Failing to comply with any of the requirements to benefit from the regime implies the obligatory regularization of the RIC. This will be made increasing the taxable base of the fiscal year in which a requirement is not observed in the amount of the RIC allocated (or increasing the tax payable in the Personal Income Tax), plus late payment interests and, if it is the case, penalties that were of application.

These rules do not apply to the requirements related to the incorrect accounting of the RIC, the absence of the investment plan, and the information that must be shown in the annual reports. In these cases, the following tax infractions are contemplated specifically:

a) Severe tax infractions:

- The lack of proper accounting of the RIC in the terms established by the Law, which is punished with a proportional fine of 2percent of the RIC allocation.
- Not recording in the Annual Reports the information required is punished with a proportional fine of 2percent of the RIC allocation that should have been declared.
- The inclusion of false, incomplete or inexact data in the Annual Reports, which is punished with a fine of 500€ per omitted, false or inexact item, with a minimum of 5,000€.

b) Mild tax infractions:

- In case of indirect RIC investments through the capital subscription of other companies, not communicating the data or communicating false, incomplete or inexact data, is punished with a fine of 150€ per false, incomplete or inexact item, with a minimum of 500€.
- The absence of filing of the investment plan, which is punished with a proportional fine of 2percent of the allocation made to the RIC to which the plan should refer.
- The omission, falsification or inaccuracy of the data that must be contained in the investment plan, will be punished with a fine of 150€ per item omitted, false or inaccurate, with a minimum of 500€.

## 2.3.2. Tax benefit for the production of corporal goods in Spain

Taxpayers subject to the Corporate Income Tax, as well as the taxpayers of the Personal Income Tax that determine their net income deriving from business activities by the method of direct appreciation, will have the right to apply a reduction of 50percent of the gross tax payable that proportionally corresponds to the net income obtained from the sale of corporal goods

manufactured in the Canaries by the taxpayer, relating to agricultural, livestock, industry and fishing activities.

### 2.3.3. Tax credit for investments in fixed assets in the Canary Islands

The tax credit for investments in fixed assets is applied in the Canary Islands despite the fact that it has been abolished in the rest of Spain. The main characteristics of this tax credits are explained below:

- The tax credit is accrued in the fiscal year in which the investments are put into the disposition of the taxpayer.
- The rate of the deduction is 25percent of the investments that qualify.
- The maximum amount of deduction that can be used to offset the gross tax payable is 50percent, although the deductions generated in previous fiscal years can be also applied with the same limit, but with a combined limit of 70percent of the gross tax payable. It is also even possible to combine deductions of several years, absorbing a full 100percent of the gross tax payable.
- It is possible to invest in certain used fixed assets, provided that these assets have not been used for this same tax credit previously and that a technological advantage is credited.

### 2.3.4 Improved tax credit for investments in the Canary Islands

Companies and other entities domiciled in the Canary Islands will be able to benefit from an increase in the general rates of the tax credits granted by the Spanish regulations to incentive the realization of certain activities. Specifically, the rates applied in the Canaries on the investments executed will be 80percent higher than the ones of the general regime, with a minimum difference of 20 percentage points. Furthermore, the limit of application of the tax credit against the gross tax payable also increases 80percent over the general regime, with a minimum difference of 35 percentage points.

In this respect, it must be borne that, as it is the case for all the other taxpayers of the Corporate Income Tax in Spain, these tax credits to incentive certain activities will be reduced progressively until its complete abolishment. To this effect, the rate of each tax credit will be reduced each year applying a reduction rate established for each tax credit.

## *2.4 Non Residents Income Tax*

The Non-residents' Income Tax is a direct tribute that taxes the income obtained in Spain by

physical or corporate person non resident therein.

Taxation of non-residents is dealt with separately from taxation of individuals and corporate residents.

## Retributions obtained through a permanent establishment

Income obtained through a permanent establishment (defined as a fixed place where a business activity is carried out in Spain) located in Spain will be taxed on the total income attributable to said establishment, regardless of the place where it was obtained or produced. Non-resident individuals or entities are taxed on their net income at the same rate, which, after the 1st January of 2008, is, as a general rule, 30percent.

Additionally there is an 21percent tax (branch profit tax, which is expected to be scaled back to 19percent after the 1st of January of 2014) on the remitted profits of non-residents doing business through a permanent establishment in Spain. In this respect, the Law provides protection to the other EU Member States and also exempts from taxation income obtained in Spain through permanent establishments by entities resident for tax purposes in a State that has signed a tax treaty with Spain.

The taxation of the income of permanent establishments is governed by the following rules:

As a general rule, the taxable base is determined in accordance with the same regulations as are applicable to Spanish-resident companies and, accordingly, the tax rate of 30percent would be applicable on the net taxable base. Allocated parent company general and administrative overhead expenses are deductible under certain conditions related to their accounting record, documentation, rationality, and continuity of the allocation criteria applied.

The permanent establishment may also take advantage of the same tax credits and benefits that might be applicable by Spanish resident companies.

For permanent establishments engaging in installation or building projects with a duration of over 6 months, for those with seasonal or sporadic activity, or for those engaged in the exploration of natural resources, the taxable base is determined in accordance with the rules applicable to non-residents obtaining income in Spain not through a permanent establishment. This implies that the taxable base will be determined as a difference between the gross income and personnel, raw materials supplies, and other supplies. The tax rate applied will be 24.75percent (will also be reduced to 24percent after the 1st of January of 2014).

However, the taxpayer may also choose to be taxed under the general rules, but such option may only be taken if separate accounting books are kept in Spain. This choice must be made at the

date of registration in the entities' index.

If the permanent establishment does not complete a business cycle in Spain which leads to income in Spain, and the business cycle is completed by the parent company or by other permanent establishments without giving any consideration to the Spanish-located permanent establishment, apart from the payment of the expenses originated by the permanent establishment and without assigning any part of the product or services generated to third parties, the payable tax is determined by applying the general taxation rules, whereby revenues and expenses are valued at market prices.

However, the tax base can optionally be applying a determined rate established by the Ministry of Economy and Finance for this purpose to the total expenses incurred. To that amount it will be added other accessory income, such as interests or royalties, which do not derive from the usual business purpose, as well as the capital gains and losses coming from assets assigned to the permanent establishment. This percentage has been established at 15percent.

The gross tax payable in this case is determined by applying the standard tax rate, but the tax credits and tax benefits provided by the standard corporate income tax system will not be applied.

## Income obtained without a permanent establishment

Non-resident entities or individuals that obtain income in Spain not through a permanent establishment will be taxed separately on each total or partial accrual of Spanish-source income.

Spanish-source income obtained not through a permanent establishment, consists mainly of the following items:

- Income derived from economic activities pursued in Spain.
- Income derived from the rendering of services where such services are used in Spanish territory, being understood as such, in particular, studies, projects, and technological assistance or management support services.
- Salary income, which is directly or indirectly derived from a personal performance made in Spain by artists or sportsmen, or any other income related to that performance, even in the case that the income is received by any other person or entity.
- Salary income for a job that was considered developed in Spain, pensions and similar income, as established in the Non Resident Income Tax Law.
- Income from securities issued by companies resident in Spain.

- Income from real estate located in Spain or from certain rights concerning them, as well as the attribution of income made to individuals for urban buildings located in Spain which are not ascribed to a business activity.
- Royalties paid by tax residents in Spain, or for permanent establishments allocated in Spain, or that are used in Spain.
- Capital gains on the sale of real estate or movable assets located in Spain and the sale of securities issued by residents in Spain, or from equity of companies, even non resident in Spain, whose main asset is real estate or rights on real estate located in Spain.
- Interest, royalties and other income from movable capital paid by individuals, corporations, or permanent establishments resident in Spain, which mean a retribution of capital used in Spain.

However, certain types of income originated in Spain are not taxable in Spain, most notably the following:

- Income paid for international sales of goods, including mediation commission and accessory expenses.
- Income paid to non-resident persons or entities relating to permanent establishments located abroad, charged to these establishments, if the consideration paid is related to the activity of the permanent establishment abroad.

Furthermore, interest and other income derived from the transfer of equity to a third party, as well as capital gains on movable assets owned by residents of other EU Member States (except tax havens) obtained not through a permanent establishment are deemed to be tax-exempt in Spain, except when they are resident in a tax haven.

In addition, gains on transfers of securities or redemptions of participation units in mutual funds on official secondary securities markets in Spain obtained by non-resident individuals or entities without a permanent establishment in Spain that are resident in a State with which Spain has signed a tax treaty and such treaty contains an exchange of information clause are also tax exempt.

On the other hand, the exemption will not apply to capital gains that derive from the transfer of property of shares, participations, or other rights on a corporation in the following cases:

- When the main assets of said corporation consist mainly in real stated located in Spain.
- When, within the twelve month period prior to the transfer, the taxpayer has held, directly or indirectly, held a participation of at least 25percent.

Furthermore, the following income is exempt from taxation:

- Income derived from Spanish Government debt securities accruing to non-resident entities obtained not through a permanent establishment, unless they are obtained through a tax haven.
- Income derived from "non-resident accounts" paid to non-resident entities or individuals, unless the payment is made to a permanent establishment in Spain of such entities, or by the Bank of Spain, or by certain listed entities to which the regulations on foreign economic transactions refer. In addition, will be exempt the income obtained from the rental or assignment of containers or ship and aircraft bare-boat, which were assigned to international air or sea transport.
- Income that derives from the transfer of property of equity and reimbursement of participation held in investment funds, obtained through any of the official secondary markets in Spain, obtained by individuals or corporations not resident in Spain, with which Spain has signed a Double Taxation Treaty with clause of information exchange, unless the income is obtained through a tax haven.
- Dividends and shares in profits received by individuals resident in other Member States of the EU or in countries or territories with which there is a clause of information exchange, will be tax exempt subject to the limit of 1,500 Euros of the entire income obtained in the calendar year, unless the income is obtained through a tax haven
- Dividends paid by a Spanish subsidiary to its EU parent company are tax-exempt in Spain, provided that certain requisites are met.

The regulations establish that the income obtained not through a permanent establishment will be taxed with rates that are, as a general rule, lower than the general rates applied to corporations or resident individuals. The tax rates are as follows (detailed the tax rates applied in 2013 and the ones expected from 2014 and later years):

| Tax rates for non resident income | | |
|---|---|---|
| **Source of income** | **2013** | **2014** |
| General | 24,75% | 24,00% |
| Dividends | 21,00% | 19,00% |
| Interests | 21,00% | 19,00% |
| Transfers or reimbursement of shares or participations in collective investment schemes | 21,00% | 19,00% |
| Special cases | | |
| Income from reinsurance activities | 1,50% | 1,50% |
| Income of shipping companies or aviation companies | 4,00% | 4,00% |
| Capital gains | 21,00% | 19,00% |
| Foreign employees on seasonal jobs | 2,00% | 2,00% |
| The tax rates applied to retirement pensions obtained by non residents, will vary between 8% for amounts up to 12.000%, 30% for the following 6,700€, and 40% for amounts in excess of 18,700€ | | |

As a general rule, the Spanish residents that pay income to non residents without a permanent establishment are obliged to practice a withholding. The tax return filed by the withholding payer liberates the non resident taxpayer of its obligation to pay and file the tax, and vice versa. There is an alternative, which is that the tax returns are filed monthly or quarterly accumulating the different types of income accrued during the tax periods mentioned above.

## Tax on property in Spain of non-resident companies

Non-resident companies that reside in a tax haven and own real estate, or hold the right to use or exploit real estate in Spain, are subject to an annual tax of 3percent.

The taxable base will be calculated based on the cadastral value of the assets as of the 31st December of each year.

## Tax regime for non-residents employees assigned to Spain (inbound expatriates)

Spanish personal income tax legislation contains a special regime for individuals assigned to Spain due to labour reasons, that allows individuals who become tax resident in Spain as a result of their assignment to Spain to choose to be taxed either by the personal income tax rules or under non-resident income tax rules during the tax period in which their tax residence changes and for the next five tax periods. Under the non-resident income tax rules option, they are only taxed on the income deemed to have been obtained in Spain at the general rate of

24percent.

The following requirements are necessary to apply this regime:

- The inbound expatriate must not have been resident in Spain during the 10 years preceding his or her assignment to Spain.
- The assignment to Spain must be the result of an employment contract.
- The work must be performed for a company or entity resident in Spain or for a permanent establishment located in Spain of an entity not resident in Spain.
- The salary income resulting from the work must not be exempt from the non resident income tax.
- The annual salary income is not expected to exceed, during any of the years in which this regime is applied, 600,000 euros.

All salary income received by the taxpayer will be subject to withholding in Spain, even when it is not paid by an entity or establishment resident or located in Spain.

In order to exercise the option to be taxed under this regime, it is necessary to file an application before the Tax Authorities within the six months following the date of commencement of the employment that was stated in the affiliation application before the Social Security.

Furthermore, taxpayers that opt for this tax regime can apply for a certificate of tax residency in Spain.

## Tax treaties

Tax treaties may reduce, or even completely eliminate, the taxation in Spain on the income obtained by entities which do not have a permanent establishment in Spanish territory.

Companies without a permanent establishment in Spain which are resident in countries with which Spain has a tax treaty are generally not taxed in Spain on their business income earned here, nor for capital gains, other than real estate ones.

However, capital gains on the sale of shares of companies can be subject to taxation in Spain under certain special clauses contained in some treaties.

## Tax representatives

Non-residents taxpayers are required to appoint a tax representative in Spain in the following cases:

- When operating in Spain through a permanent establishment.
- When developing economic activities in Spain without a permanent establishment, in the cases where the deduction of certain expenses is granted.
- Entities subject to the attribution of income regime that develop business activities in Spain, and all or a portion of the activity is developed usually through installations or workplaces of any kind, or which act in Spain through an agent authorized to conclude contracts in the name and for the account of the entity.
- When they are specifically required to do so by the tax authorities because of the nature or the amount of income obtained.
- Persons and entities resident in countries or territories with which there is no effective exchange of tax information clause, if they are owners of property situated or rights which are fulfilled or exercised in Spain, with the exception of securities listed on organized secondary markets.

The aforementioned taxpayers are required to appoint an individual or corporation that is Spanish resident as their tax representative before the end of the period for filing the tax return for the income obtained in Spain. The appointment must be notified to the authorities within two months. Failure to appoint a representative or to notify the authorities can lead to a fine of 2,000€. Such penalty will amount to 6,000€ for those taxpayers residing in countries or territories with which there is no effective exchange of tax information clause.

In the cases where the tax representative has not been appointed, the Tax Authorities can consider that are tax representatives of permanent establishments whoever persons or corporations registered as representatives in the Mercantile Register, or the persons empowered to contract on their behalf.

The following representatives can be jointly and severally liable for the payment of the taxes due:

- Representatives of permanent establishments of non-resident taxpayers, or
- Entities under the regimen of income attribution.

Furthermore, the payer of income accrued without the intermediation of a permanent establishment by non-resident taxpayers, or the depositary or manager of the assets or rights of non-resident taxpayers without a permanent establishment in Spain, shall be jointly and severally liable for the payment of tax debts relating to income paid by him or to income and/or gains from assets or rights whose deposit or management has been entrusted to him.

This liability shall not exist where the payer or manager is subject to the obligation to withhold and pay the tax.

Finally, the depository and the manager of the assets of a non-resident, or the entity that pays income to a non-resident are jointly and severally liable for the tax liabilities arising from those assets or on such income when there is no withholding obligation.

## *2.5 Property Tax*

The property tax is a direct tax on the net value of the wealth of individuals. This tax has been exempted for the period 2008-2010, and has been reinstated for the period 2011-2013.

In the case of taxpayers that are non residents in Spain, they will be subject to taxation only for the assets and rights placed or exercised in Spain. Nevertheless, tax treaties may affect the application of this rule. On the other hand, non resident taxpayers will not benefit from the total elimination of the tax after 2014.

## *2.6 Inheritance and Donations Tax*

The inheritance and donations tax is levied on the increase of wealth obtained without consideration from another individual, both by inheritance or by donations. It will be levied in the whole Spanish territory, including to these effects the Canary Islands, being the taxpayers the Spanish resident heirs and beneficiaries, for all the goods received, be it in Spain or abroad. In case of non resident beneficiaries, they will be subject to the tax in the modality named "real obligation", which means that they will be subject to taxation only for the goods and rights acquired, whichever its nature that were located or were to be exercised in Spain. In case of non resident taxpayers, it should be also taken into account that some Double Taxation Treaties signed by Spain change these rules.

### 2.6.1 Tax benefits in the transfers of companies

The taxable base can be reduced by 95percent if it results from a **inheritance transfer** to spouses, children or adopted children or, in their absence, ascendants, foster parents or collateral relatives up to the third degree of an individual enterprise, a professional business, or a share or participation in entities or usufructs on them which meet all the requirements to apply the so called family business exemption from property tax. The requirements are the following:

- The beneficiary of a transmission "mortis causa" must keep the assets received for at least 10 years.

- The beneficiary cannot carry out transactions that result in a substantial diminution in the value of the assets.

In the case of business or shares held in the Canary Islands, if certain requirements are met, the reduction can reach 99percent.

The **"inter vivos" transfers (donations)** of interests in an individual enterprise, professional business or in entities belonging to the donor which are exempt from property tax to spouses, descendants or adopted children provided that the following requirements are met (in addition to meeting the requirements previously detailed for inheritance tax):

- The donor must be at least 65 years old or be permanently disabled.
- If the donor had been performing management duties, he will cease in the exercise of its faculties and will cease receiving any consideration for such activity, from the moment the transfer happens.
- The beneficiary must keep the goods transferred and be entitled to the exemption of the Property Tax in the following ten years from the date of deed of donation, unless the beneficiary dies.

### 2.6.2. General Aspects

The tax is calculated by applying a tax scale of progressive rates (depending on the value of the estate or donation) applying also a coefficient that takes into account the previous wealth and the degree of kinship with the transferor.

Inheritance and donation tax Law also provides that in the case of inheritances, the tax must always be paid in the Autonomous Community in which the deceased was habitually resident, except in the case of non-resident transferors, where the jurisdiction will rest in the Madrid Tax Delegation.

As for acquisitions of assets or rights by way of donation, or any other transactions subject to this tax, the tax return must be filed in the Autonomous Community where the acquirer is habitually resident, except in the case of transfers of real estate, where the Autonomous Community with jurisdiction will be that in which the property is located.

The following tables show the reductions, rates and coefficients to be applied in case of inheritance transactions, considering the amounts applied in the Canary Islands:

| Reductions in the taxable base in transimissions "Mortis Causa" | | |
|---|---|---|
| | **Acquirers** | **Reduction** |
| **By degree of kinship** | Group I: Children and adopten children under 21 | Under the age of 10 years, up to 138,650€<br>Between 10 to 15 years, 92,150€<br>Between 15 to 18 years, 57,650<br>Between 18 to 21 years, 40,400€ |
| | Group II: Children and adopted children aged 21 and older, spouses, de facto spouses, ascendants and adoptive ascendants | Spouses: 40,400€<br>Children or adopted children: 23,125€<br>Other descendants: 18,500€<br>Ascendants or adopting parents: 18,500€ |
| | Group III: Collateral family members in second and third degree of kinship, ascendants and descendants by affinity | 9,300€ |
| | Group IV: Collateral family members in fourth degree of kinship or further, and nonfamily heirs | No reduction |
| **Por otras reducciones** | Physically, mentally or sensorial disabled persons (disability with a degree between 33% to 65%) | 72,000€ |
| | Physically, mentally or sensorial disabled persons (disability equal or greater than 65%) | 400,000€ |
| | Taxpayers aged 75 years or older (non compatible with disability reductions) | 125,000€ |

With respect to tax rates, the rates are progressive, going from a 7.65percent for net taxable bases lower than 7,993.46€, up to 34percent for bases that exceed 797,555.08€.

| Tax rates | | | |
|---|---|---|---|
| **Tax base (up to Euros)** | **Tax payable (Euros)** | **Remaining Tax Base (up to Euros)** | **Applicable rate (%)** |
| 0 | | 7,993.46 | 7.65 |
| 7,993.46 | 611.5 | 7,987.45 | 8.5 |
| 15,980.91 | 1,290.43 | 7,987.45 | 9.35 |
| 23,968.36 | 2,037.26 | 7,987.45 | 10.2 |
| 31,955.81 | 2,851.98 | 7,987.45 | 11.05 |
| 39,943.26 | 3,734.59 | 7,987.45 | 11.9 |
| 47,930.72 | 4,685.10 | 7,987.45 | 12.75 |
| 55,918.17 | 5,703.50 | 7,987.45 | 13.6 |
| 63,905.62 | 6,789.79 | 7,987.45 | 14.45 |
| 71,893.07 | 7,943.98 | 7,987.45 | 15.3 |
| 79,880.52 | 9,166.06 | 39,877.15 | 16.15 |
| 119,757.67 | 15,606.22 | 39,877.15 | 18.7 |
| 159,634.83 | 23,063.25 | 79,754.30 | 21.25 |
| 239,389.13 | 40,011.04 | 159,388.41 | 25.5 |
| 398,777.54 | 80,655.08 | 398,777.54 | 29.75 |
| 797,555.08 | 199,291.40 | Upwards | 34 |

In addition, the tax payable can be increased with the following coefficients, which are applied on the basis of the kinship and previous wealth of the beneficiary or heir:

| Coefficients based on degree of kinship and previous net worth | | | |
|---|---|---|---|
| | Groups under article 20 | | |
| Previous net worth (in Euros) | **I y II** | **III** | **IV** |
| **0-402,678.11** | 1 | 1.5882 | 2 |
| **>402,678.11- 2,007,380.43** | 1.05 | 1.6676 | 2.1 |
| **>2,007,380.43 – 4,020,770.98** | 1.1 | 1.741 | 2.2 |
| **> 4,020,770.98** | 1.2 | 1.9059 | 2.4[1] |
| **1 This coefficient is applicable if the successors are not known, without prejudice to the refund of the respective amount when they are known.** | | | |

## *2.7 Municipality Taxes*

As it is the case in the rest of Spain, municipalities in the Canary Islands are empowered to establish taxes. Nevertheless, the legislative competence of the municipalities is limited by a national Law.

In the following paragraphs it is described summarily the main local taxes:

- Tax on real estate (IBI): This tax is levied annually on owners of real estate or on holders of rights over real estate in the Canary Islands, and which is levied each year based on the cadastral value determined by the Property Cadastre, an administrative body of the Spanish government.
- Tax on business activities (IAE): This direct tax is levied annually on any business activity conducted by any type of corporation. Individuals that develop business activities of any sort are exempt, as well as the corporations whose net sales (at group level) are below 1,000,000€.
- Tax on buildings, installation projects and construction works (ICIO): This tax is levied on the actual cost of any work or construction activity that requires prior municipality permission.
- Tax on increase in urban land value: This tax is levied on the increase disclosed in the value of urban land whenever land is transferred, be it between individuals or between entities. The tax base is determined by reference to the cadastral value of the land when the transfer of property happens, and taking into account the time that the land has been held.
- Tax on motor vehicles: This tax is charged on the ownership of any type of motor vehicles apt for street use and is levied annually.

# Chapter 3:

# Indirect Taxation

# 3. Indirect Taxation

In the following sections we cover the main indirect taxes, understood as the taxes that charge the income when it is displayed; that is, its use, consumption, expenditure, transfers of property, etc.

## *3.1 Inclusion of the Canary Islands in the European Community Customs Area*

The Autonomous Community of the Canary Islands, as well as the rest of Spain, belong to the European Community customs area (with the only exception of Ceuta and Melilla). This means that there exists a full freedom of movement of merchandise to and from the Canaries destined to or with origin in any other country of the European Union, without the accrual of customs duties in operations made within the European Community customs area.

This way, and despite the fact that the Canary Islands enjoy a extremely advantageous tax regime, which reduces significantly the indirect taxation burden, for customs purposes it is just another territory belonging to the European Union, so that no customs duties are imposed in its commercial operations with other territories of the European Union.

## *3.2 General Indirect Canary Tax*

Despite the fact that the Canary Islands belong to Spain, and hence to the European Union, the Value Added Tax (VAT) is not applied in the Canaries. Instead, the General Indirect Canary Tax (IGIC) is applied, which regulation is very similar to the VAT, and in most cases coordinated, but which is tailored to the particular conditions of the Canary Islands as an Ultra-peripheral Region of the European Union.

This way, IGIC, in effect since the 1st January of 1993, is a national tax of indirect nature that taxes the transfer of goods and services, applied over the production factors incorporated into each phase of the productions process.

### 3.2.1 Operations subject to the tax

The IGIC is taxed on imports, delivery of goods, construction and provisions of services, taxing the production factors incorporated in each phase of the productive process.

Therefore, IGIC taxes the following operations:

- Transfer of goods and services made by companies and individuals.

- Imports of goods, understood as the introduction of goods in the Canary Islands, regardless of its destination and the condition of the importer.

The so-called intra-communitarian operations do not constitute taxable events in IGIC, because the introduction of goods in the Canary Islands coming from any territory outside the Archipelago are qualified as imports, even the ones originated in Spain, other countries of the European Union, or any other country.

The scope of application of the tax is the territory of the Canary Islands, the surrounding sea up to the limit of 12 nautical miles, and the air space corresponding to this territory. Nevertheless, it must be observed the international treaties and conventions that form part of the Spanish law system.

### 3.2.2 Operations non subject to taxation

There are certain operations that are not subject to taxation in IGIC, among others, the following ones:

- The transfer of a collection of assets that, as a whole, constitute an autonomous economic unit
- Deliveries of money
- Private employment and government employment
- Self-consumption of goods and services
- Operations made without a consideration
- Operations made by a public authority
- Public concessions and administrative authorizations

### 3.2.3 Internal operations

## Taxable event

It will be subject to the tax, under the concept of transfers of goods and services, the operations performed by companies and individuals, for valuable consideration, made regularly or occasionally, in the development of a business or professional activity, even the ones made in favour of partners, associates, members or shareholders, as well as the non monetary contributions to the capital of any sort of company, and the attribution of buildings promoted by general partnerships to its members.

## Exemptions

In the following table is shown the main internal operations exempt from IGIC, that follow a regulation very similar to Spanish VAT:

| Internal operations exempt from IGIC | |
|---|---|
| Hospitalization and medical care | Bills of Exchange, promissory notes, checks and alike |
| Deliveries of blood, plasma and tissue | Lottery |
| Services rendered by dentist and prosthodontists | Original Works of art |
| Social Security operations | Intellectual property |
| Cessions made by religious institutions | Delivery of recovery materials |
| Transportation of injured and sick people | Delivery of goods in whose original acquisition the IGIC borne could not be deducted |
| Social assistance | Delivery of goods in whose original acquisition the IGIC borne could not be deducted |
| Educational services | Private clases |
| Operations made by non-lucrative entities | Assurance and reasurrance operations |
| Services related to sports and phyisical education | Financial operations |
| Cultural services | Special regime for retailers |
| Entities that render services to their members | Second and subsequent transfers of bulding |
| Public postal service | |

Some of these exemptions are especially relevant in the IGIC regulation, so that a further detail is given in the following paragraphs of the special regime for retailers, which is particularly relevant:

**Special regime for retailers**

Deliveries of goods made by retailers are exempt from IGIC. Retailers are traders that habitually make sales of goods, so that more than 70percent of their sales are to final customers or to the Social Security in establishments located in the Canary Islands. The IGIC borne by the retailers is not deductible, and also bear a surcharge in the IGIC paid in the import of the goods destined to

the retail activity.

This regime has the advantage that it does not translate to the final purchase price of goods the IGIC quote on the commercial margin, as it is exempt. Notwithstanding that, business that acquire goods to retail companies will be able to deduct the IGIC that is implicit in the operations made.

This exemption regime does not cover the transfer of goods and services made by the retailers beyond the retail business, as well as the import of goods that are not assigned to the retail activity.

### 3.2.4 Allocation of the taxable event

The scope of application of the tax is placed within the Canary Islands. Nevertheless, in case of international business relationships with the Spanish mainland, Balearic Islands, Ceuta and Melilla, and other countries, the following allocation rules are of application:

## Transfer of goods

As a general rule, they will be considered to be made in the place where the good is put at the disposition of the acquirer. However, the following special rules must be mentioned:

- Goods that must be shipped to be put at the disposition of the acquiror. The transfer of these goods will be considered to be made in IGIC territory if the transport starts in the IGIC territory.

  Nevertheless, in case of goods to be imported which were placed at the beginning of the transport outside the Canary Islands the delivery made by the importer or by subsequent transferors will be understood to be made in the Canary Islands.

- Goods that must be installed or assembled before they are put at the disposition of the acquirer. Their delivery is considered to take place in the Canary Islands if the installations was finished in the Canary Islands, provided that they result in the immobilization of the goods and they are not irrelevant (that the cost of assembly does not exceed 15percent of the consideration).

- Real estate transfers of property: They will be allocated in the place where the assets are.

- It will be considered as made in the Canary Islands, and hence subject to taxation for IGIC, the transfer of goods and the rendering of services to the passengers of planes or ships when

the place of start and end of the trip is in the Canary Islands territory, and there are not layover outside the Canary Islands.

## Services

The general rule for the allocation of services is as follows:

- Main office or establishment of the service provider, when the receiver is not a business or professional acting as such.
- Main office or establishment of the receiver, when the receiver is a business or professional, provided that the services are rendered by the person or company established in the Canary Islands and the services are destined for the domicile, permanent establishment or primary residence.

Nevertheless, it must be noted that there are many special rules, of which the most relevant are explained below:

- Services made on movable property are considered to be allocated, as a general rule, in the place where the service is effectively rendered if the receiver is not a business or professional. Mediation services in real estate operations will be allocated always in the place where the real estate is.
- Telecommunications, radio broadcasting and television services will be considered to be rendered in the Canary Islands in the following cases:
    - If the receiver is a business, when it has its main office, permanent establishment or domicile in the Canary Islands.
    - If the receiver is not a business, when it is resident or domiciled in the Canary Islands and uses or exploits the services in the Canary Island; likewise, when, the receiver is domiciled outside the European Union, but the service provider is located in the Canary Islands. It is understood that the receiver is resident or has an establishment in the Canary Islands if the payment of the service is made using bank accounts located in the Canary Islands.
- Same rule applies to the mediation in these services, when the mediator and the manager act on their own name but on behalf of others.
- It is allocated in the Canary Islands the mediation and management of any other services allocated in the receiver's place, when the receiver is established in the Canary Islands.
- Services directly related to real estate property, including the services of mediation in

transfers of property, will be located always where the real estate is placed.

- The mediation in services other than the ones related to real estate, and the ones allocated in the receiver place, will be allocated in the same place as the main operation.

### 3.2.5 Taxpayer

The taxpayer is the company or individual that, acting as a business or professional, to IGIC purposes, performs the operations of delivery of goods or service renderings subject to the tax. Other entities will also have that consideration, such as inheritances or joint ownerships.

As a special rule, there will happen the reversal of the taxpayer position in the companies or professionals and, anyway, in public entities and entities that do not act as businesses or professionals, which receive the operations subject to taxation in the following cases:

- When the aforesaid operations are made by persons or entities that are not established in the Canary Islands, unless the receiver, at the same time, is not established therein.
- When the operations are made following the order of a sentence or similar mandate issued by a Court of Justice or the Authorities.
- Transfer of goods as substitute of payment with money, and transfers of assets made within a bankruptcy procedure.
- Second transfer of property that as a general rule are exempt from IGIC but where the acquirer has renounced to the exemption.
- When consists of unelaborated gold deliveries or semi-elaborated golden products, of an assay value that equals or is higher to 325 thousandths.
- In certain cases of deliveries of garbage, waste or leftovers of ferric materials, paper, cardboard, paper, glass, and others.

### 3.2.6 Imports of goods

It is understood that an import of goods is the introduction of the goods in the Canary Islands, proceeding from the Spanish mainland, the Balearic Islands, Ceuta, Melilla, any other countries of the European Union or third countries, whichever is the purpose of the goods or the condition of the importer. It will also be understood as an import the authorization for consuming in the Canaries of goods that were included in the regimes of temporal import, transit, active improvement in the suspension or deposit system, as well as customs-free areas and warehouses.

It will also be considered as an import the acquisition in the Canaries of goods whose delivery or previous import had applied one exemption due to the regulation of the diplomatic, consular, and international entities system.

The taxpayer is always the person or entity that imports the goods, regardless of its condition or the destination given to the goods.

## Exemptions

In definitive imports of goods

The Law establishes an extremely detailed relation of import operations that are exempt, of which the most relevant is the exemption on the import of ships, even navy ships, or ships destined to international navigation, or to coastal fishing, along with operations that are of small value or which do not have a business purpose. Some of them are the following:

Imports of gifts given usually as wedding presents, received by couples that, as a result of its wedding, move their residency from the Spanish mainland, the Balearic Islands, Ceuta, Melilla, or foreign countries to the Canary Islands. The unit value of each item is fixed in 350€ or 200€, depending on whether their previous residence had been in the European Union or third countries, respectively.

Imports of goods whose value at a whole does not exceed 150€, in effect since the 1st of December of 2008, with the exception of:

- Products containing alcohol, listed in references NC22.03 to NC22.08 of the Customs Tariff
- Perfumes and eau de cologne; and
- Tobacco plant or manufactured tobacco.

On the other hand, the exemption covers the goods sold by mail order.

Special import regimes: the following operations are exempt:

- Imports of goods made within transit areas, temporal import and active improvement
- Imports of goods placed in deposit regime or in areas and warehouses placed in customs free areas
- Services related to the imports mentioned above
- Mediation services made on behalf and in the name of third parties, related to the

operations mentioned above

### 3.2.7 Exports

The following exports are exempt:

- Delivery of goods, with a definitive character, to the Spanish mainland, Balearic Islands, Ceuta, Melilla, other country of the European Union, as well as the ones exported finally to third countries by the seller or by a third party in its name and in its behalf.
- Delivery of goods, with a definitive character, to the Spanish mainland, Balearic Islands, Ceuta, Melilla, other countries of the European Union, as well as the ones exported finally to third countries by the non-established acquirer or by a third party in its name and in its behalf. The exemption does not cover the delivery of goods destined to the equipment or provisioning of sports or leisure boats, tourist planes or any other ways of transportation destined to the private use of the acquirer.
- Work made on movable properties acquired in the Canaries, or imported with the purpose of being subject to such work, and later being exported.
- Delivery of goods to organizations duly acknowledged that send the goods definitively outside Canaries as part of their humanitarian, charitable or educational activities, although the exemption must be granted previously.
- Services, including transport and accessory operations, when directly related to the exports or shipments to the Spanish mainland, Balearic Islands, Ceuta, Melilla, and the European Union.
- Mediation services related to the exempt operations listed above, made on behalf and in the name of a third party, or the ones made outside the Canary Islands.
- The exemption also applies to certain operations assimilated to exports, such as operations made in ships and planes, operations made within the framework of diplomatic relations, deliveries of goods and services rendered to certain international organizations, deliveries of gold to the Bank of Spain, transportation of passengers and their luggage by ship or by plane which, starting in the Canary Islands, arrives in the Spanish mainland, Balearic Islands, Ceuta, Melilla, any country of the European Union, or third countries, or vice versa, as well as certain operations made in Zones or bonded warehouses, or similar.

### 3.2.8 Taxable base

As a general rule, the taxable base is the total amount of the consideration agreed, not including

compensations, discounts or bonus that have been recorded outside the invoice, as well as reimbursable expenses.

### 3.2.9 Tax accrual

The moment in which the tax is accrued depends on the following:

- The deliveries of goods, when they are put at the disposition of the acquirer, or, being the case, when they are executed in accordance with the regulations.
- Services, when they are rendered, executed or made effective, or, if it is the case, when the asset over which the services are executed is put at the disposition of the acquirer.
- In the transfer of goods between the principal and the commission agent, executed by virtue of a sales commission agreement, when the agent acts in its own name, at the time the principal delivers the goods.
- In the transfer of goods between the principal and the commission agent, executed by virtue of a purchase commission agreement, when the agent acts in its own name, at the time the agent obtains the goods.
- In operations subject to taxation which cause anticipated payments prior to the taxable event, the tax will be accrued at the moment of total or partial perception of the price, for the amounts effectively obtained.
- In the lease of assets, supplies, and any other operations with successive intervals, the accrual happens each time that the payment of a part of the price can be requested, or at the end of the year, for the amounts pending of accrual at that date.

### 3.2.10 Tax rates

Tax rates in IGIC are the following:

- Zero rate : 0percent
- Reduced rate, only for certain housing operations: 2,75percent
- Reduced rate: 3percent
- General rate: 7percent
- Increased rates: 9,5percent and 13,5percent

On the other hand, there is a special IGIC rate for operations and imports of tobacco, at 20percent, with the exception of cigars.

### 3.2.11 Deductions and refunds

IGIC taxpayers which, acting as business or professionals, had duly filed the forms required by Law and started effectively their activity of delivery of goods or rendering of services, will be able to practice a deduction of the IGIC borne in their operations, provided that the tax paid was accrued in the Canary Islands, had been borne by direct repercussion in the acquisition of goods or services, insofar such goods or services had been used in the execution of operations subject and non exempt from taxation, or in certain exempt operations that nevertheless grant the right to deduct, such as exports, operations assimilated to exports, telecommunication services, certain financial operations made outside the European Union, etc.

Furthermore, it must be noted that if at the end of each year the net result of IGIC deductible is positive, the taxpayer can ask the refund in the last annual tax form, and that even exists a special regime that provides for monthly refunds, if certain requirements are met. Finally, in certain cases, non residents can ask for the refund of IGIC tax quotes paid in the Canary Islands.

Finally, it will be deductible, from the moment that this right is generated, the tax paid in imports, in the reversal of the taxpayer position, and in case of substitution in the exemption related to the acquisition of investment assets.

#### Date in which the right to deduct comes into effect

The right to deduct, even in the case of imports, is born at the moment that the tax borne is accrued.

#### Exercise of the right to deduct

The time limit to practice the deduction is 4 years after the birth of the right to deduct. The percentage of deduction of the tax borne will be the definitive percentage in the year in which the right to deduct was born.

#### Expiration of the right to deduct

The right to deduct expires when it has not been exercised by the taxpayer in a four years period.

### 3.2.12 Formal requirements

IGIC taxpayers are obliged to observe the following requirements:

- File census declarations related to the beginning, modification and cease of the activities

that determine is subjection to the tax, unless it is business or professionals that perform only internal operations exempt from IGIC (apart from retailers).

- Issue and deliver invoices of the operations and keep a copy of the documents mentioned.
- Keep the invoices and substitute documents received from suppliers.
- Maintain certain books (to register invoices issued, invoices received, and investment assets).
- The taxpayers that were obliged to file IGIC tax returns by electronic means, must file an informative statement with the content of their books of invoices issued, invoices received, and investment assets per each IGIC period. This requirement is effective from the 1st January of 2009 only for taxpayers that apply for the Register of Monthly refunds. For the remaining taxpayers, this requirement will be necessary for the first time in 2014.
- File, periodically or at the request of the Tax Authorities, some information related to their economic relationships with third parties.
- File the tax forms corresponding to each IGIC period, unless they are business or professionals under the regime of retailers, for the operations covered by this regime, or that perform only internal operations exempt from IGIC, or exports operations, or assimilated to exports exempt from IGIC, and/or operations at zero rate, unless the right to deduct the IGIC borne is to be exercised.
- File certain informative forms with an annual frequency, offering information that summarizes the operations of the fiscal year.

### 3.2.13 Other formalities

IGIC tax returns can be filed by the taxpayer at some bank offices that cooperate with the Tax Authorities, or directly before the Tax Authorities, at the offices of the Canary Islands Tax Offices corresponding to the geographical scope in which the tax domicile or the permanent establishment of the taxpayer is located. If there were several permanent establishments in the Canary Islands, the forms will be filed where the main administrative and management offices are located. If it were not possible to locate such an establishment, it will be the establishment whose fixed assets have the highest value.

On the other hand, taxpayers whose volume of operations for its economic activities taken as a whole had exceeded in the previous year 6,010,121.04€ must file the tax monthly instead of quarterly. There is the exception of taxpayers which, as a regular activity, import and sell motor vehicles destined for road traffic, which will file their tax returns quarterly; on the other hand,

taxpayers that have been authorized to ask for the devolution of their credit balance at the end of each period will have to file the tax returns monthly. In addition, the so called Occasional Returns must be filed monthly.

Taxpayers can apply for the devolution of the credit balance at the end of each period, which will be one month, regardless of the volume of operations.

To apply for the monthly devolution of the credit balance, some additional requirements must be met and the taxpayer must be inscribed in the Register of monthly devolutions.

## *3.3 Duty on import and delivery of goods*

In the following paragraphs it is explained the main characteristics of the Duty on import and delivery of goods (Arbitrio sobre Importaciones y Entregas de Mercancias, or AIEM), in effect since the 1st January of 2002, as it is one of the particularities of the economic and tax regime of the Canary Islands.

It is a state indirect tax which has the purpose of promoting the manufacturing the certain goods in the Canary Islands, and which tax only once the manufacturing of corporal goods and the imports of such goods in our territory.

As well as the IGIC, its geographical scope covers the Canary Islands, including the surrounding sea up to the limit of 12 nautical miles. The tax events that trigger the AIEM tax are any of the following:

- Deliveries made by business, regularly or occasionally, by a consideration, of movable corporal goods as listed in Annex IV of the IGIC Law, manufactured by them. Second and subsequent deliveries will not be subject to the tax.
- Imports of goods as listed in Annex IV of the IGIC Law.

As it has already be hinted, the AIEM tax will only be accrued when the taxable events happen but only in relation with the goods listed in Annex IV, where it is also listed the tax rate applied to each good, so that the tax rate is the same for imports and internal deliveries, unless the last one is exempt, as in Annex V it is listed the goods that are exempt (although there are other exemptions in the Law).

Furthermore, a special simplified regime is regulated for the businesses that do not reach a certain volume of operations (the amount is fixed each year), and, as well as the IGIC case, the taxpayers must observe certain formalities imposed by the Law.

## *3.4 Transfer tax and stamp duty*

Transfer tax and stamp duty is an indirect tax that is divided in the following categories:

- Corporate transactions -OS- (such as incorporation, capital increase/reduction of companies): the tax rate in the Canary Island is 1percent.
- Transfer of economic goods -TPO- (transfers of goods or rights that belong to individual wealth, and certain transfers of property of corporations): the tax rate in the Canary Islands is 6.5percent for real estate operations.
- Stamp duty -AJD- (mercantile, administrative or public documents): the tax rate in the Canary Islands is 0.75percent, or 1percent for certain operations that are also subject to IGIC.
- This tax has the followings characteristics:
- The categories of the transfer tax and stamp duty are incompatible, this is a same transaction can only be subject to one of the categories of this tax at the same time. Furthermore, stamp duty is not compatible with TPO and OS.
- It will not be subject to TPO the transactions carried out by professionals or businessmen during their business activities, when those transactions fall within the scope of the Added Value Tax or Canary Island Indirect General Tax.

However, it will be subject to TPO the transfer or renting of real estates, as well as constitution or transfer of real estate rights, when those operations are exempt from the Added Value Tax or Canary Island Indirect General Tax. The transfer of the total business assets of the taxpayer will be subject to TPO only if it were not subject to the Added Value Tax or Canary Islands Indirect General Tax.

- Transfer of shares of Spanish companies, listed or not in a secondary market, is generally exempt from VAT, IGIC, and transfer tax or stamp duty. Nevertheless, there is a relevant exception, which is that transfers of shares in a secondary market, or the subscription of shares in a primary market as a consequence of the exercise of a subscription right, conversion of bonds into equity, or acquisition through any other operation, of more than 50percent of the capital stock of a company (or increasing the stake in the entity when the acquirer already has more than 50percent) and at least 50percent of the assets of such company consist of real estate properties located in Spain: in this case, the transaction will be considered for indirect taxation purposes to be a transfer of real estate subject to TPO at 6.5percent. Nevertheless, this rule does not apply when the buildings are used for an

economic activity.

- In real estate transfers, taxpayers not resident in Spain will have their tax domicile, for the purposes of compliance with their transfer tax and stamp duty obligations, in the domicile of their representative, who must have been appointed pursuant to the Non Residents Income Tax Law. In the event of failing to appoint a representative or to notify the authorities, the tax domicile of the non-resident taxpayer will be deemed to be the real estate transferred.

## *3.5 Special taxes*

In Spain there are several types of special taxes, in accordance with the Directives of the European Community. Special taxes are imposed on certain consumer goods (alcohol and alcoholic beverages, beer, petrol-derived fuel, tobacco industry, certain ways of transportation, and coal), in each one of manufacturing, transforming or importing the goods.

In the Canary Islands there are certain particularities as the Canaries do not fall within the European Community territory scope regarding special taxes. Nevertheless, in the Canary Islands the following special taxes are levied:

- Special tax on fuel deriving from petrol: This tax has a specific regulation for the Canary Islands, contained in Law 5/1986, of the 28th July, issued by the Parliament of the Canary Islands. This regulation establishes tax rates which in practice are much lower (less than 50percent) of the ones applied in the rest of Spain. As an example, unleaded gas in the Canaries bear a tax of 265 € per each 1,000 litres, whereas in the rest of Spain the tax is 400.69€ per each 1,000 litres.
- Special tax on alcohol and alcoholic beverages: it is applied in the Canary Islands, although the tax rates are lower than in the rest of Spain, with respect to the following products:
    - Special tax on beer
    - Special tax on intermediate products
    - Special tax on alcohol and fermented beverages
- Special tax on electricity (applied to the whole Spanish territory). This tax is borne on the production, import and acquisition of electricity within the European Union. The tax rate, which is always the same in Spain, is 4.864percent on a basis resulting from multiplying by 1.05113 the taxable base of VAT or IGIC accrued when the electricity consumption is invoiced to the user.
- Special tax on certain means of transportation: This tax is borne on the first definitive

licensing of certain ways of transportation, new or used, propelled by an engine. Depending on the type of vehicle, the tax rate goes from 4.75percent to 12percent. In the Canary Islands, the rates go between 3.75percent and 11percent, applied on the value of the vehicle.

## *3.6 Taxes exclusive to the Canary Islands*

With effect on the 1st of July of 2012, there are two new taxes specific to the Canary Islands:

- Environmental tax that applies over commercial areas. This tax, of environmental nature, taxes the damage caused by big commercial areas. The tax rate applied yearly depends of each island, varying between the 12.00 € per square meter in Gran Canaria and Tenerife and 2.40 € per square meter in La Gomera y el Hierro.
- Environmental tax on certain activities: this figure taxes each year the development in the Canary Islands of activities of distribution of electric power, destined to final consumers or retailers, through main lines with power equal or higher than 20 kv. The tax is paid in proportion to the kilometres of aerial power lines, with a tax quote that, depending of the tension of the power grid, goes from 600 € to 750 € per kilometre of aerial power line.
- In addition, it is subject to taxation the service of electronic communications, being subject to the tax the elements forming the telecommunications infrastructures, with a tax rate of 500 € per year for each element of the infrastructure (towers, masts, antennas, panels, radio elements).

## *3.7 Tax Benefits on Indirect taxation exclusive to the Canary Islands*

Companies subject to the corporate income tax, domiciled in the Canary Islands, and the ones that act in the Canaries through a permanent establishment, when the tax yield is considered to be produced in the Canary Islands, will be exempt from the Transfer Tax in the following cases:

- In the category of onerous transfer of assets, for the acquisition of investment goods and intangible assets that qualify as initial investment (in similar terms to RIC). In the case of acquisition of intangible assets, the exemption will be limited to 50percent of its value, unless the taxpayer meets the requirements to be considered a small sized company.
- In the category of corporate transactions, for the incorporation of companies and their capital increases, for the amount that is destined to the acquisition or import of investment goods or acquisition or cession of intangible assets that qualify as initial investment (in similar terms to the RIC). Capital increases to compensate credits will never be covered by

the exemption.

Furthermore, companies subject to the Corporate Income Tax, domiciled in the Canary Islands, and the ones that act in the Canaries through a permanent establishment, which do not have the right to deduct fully the IGIC borne, will be exempt from IGIC in the following cases:

- In the acquisition or import of investment goods that qualify as initial investment, when the taxpayer is the acquirer or importer of the assets.
- In the services of cession of certain intangible assets, when the taxpayer is the cessionary. In this case, the exemption will be limited to 50percent of the value, unless the acquirer meets the requirements to be considered a small sized company.

# Chapter 4:

## Other tax benefits exclusive to the Canary Islands

# 4. Other tax benefits exclusive to the Canary Islands

## *4.1 The Canary Islands Special Zone*

The Canary Islands Special Zone (ZEC), is a **low taxation area** which was created within the Economic and Tax Regime of the Canary Islands with the purpose of promoting the establishment of new businesses in the Canary Archipelago. One key issue to consider is that there is a clear definition of the geographical areas in which the companies can be allocated, as well as a closed list of authorized economic activities that can apply for this special tax regime.

The ZEC regime, as a State Aid, is subject to the authorization of the European Union. The present period of authorization grants the application of the regime until 31st of December of 2013 for new applications, and the application of the tax regime until 31st of December of 2019.

In this sense, Law 19/1994, of the 6th July, defines the low taxation area for Gran Canaria, which comprises an area of up to 150 hectares divided into five zones:

- La Luz Port-Conurbation of Las Palmas de Gran Canaria-Arucas
- Arinaga, Formas Bay
- Industrial Area of Telde
- Airport Park – Las Majoreras
- North-western area

In the areas mentioned it will be possible to develop a closed list of business activities regarding the manufacturing, transformation, handling and marketing of goods, which must be allocated in these areas in order to apply for the benefits of the ZEC regime.

On the contrary, the entities whose business purpose is the rendering of services, will be able to establish their business anywhere within the Canaries and will be able to apply for the ZEC regime, provided that they obtain the required authorization, and meet other requirements that will be mentioned in the following pages.

### 4.1.1 Requirements that must be met by companies in order to apply for the special tax regime applied to ZEC entities

Companies that want to file for the ZEC special tax regime must be newly created corporate entities, authorized and registered before the Official Register of ZEC entities, meeting, among

others, the following requirements:

- Being a newly incorporated entity, whose domicile and head office are located within the geographical area of the ZEC
- At least one of the members of the board of directors must be resident in the Canary Islands.
- Execute a minimum investment of 100,000€, in the case of Gran Canaria, in fixed assets, corporal or intangible, placed within the ZEC geographical area and assigned to the business activity, within the first two years after the date of the authorization. These investments must also meet the following requirements:
    - If they are new assets, must remain in the ZEC entity during the whole period of application of the regime, or during its useful life if shorter, without being transferred. Furthermore, they cannot be leased or lent to third parties, unless this is the company purpose or the business activity of the ZEC entity, provided also that the lessee or tenant are not related parties. It will be understood that the requirement of maintenance is not breached if the assets are transferred but the amount obtained is reinvested in other fixed assets in the same conditions within one year.
    - If the assets are used, they cannot have been applied previously as valid investment for ZEC purposes.
- Creation of at least 5 jobs, in the case of Gran Canaria, within the 6 months following the date of the authorization, and maintain an average workforce of at least 5 jobs during the period in which the company is registered as a ZEC entity.
- Its corporate purpose must comprise any of the activities listed for ZEC purposes.
- Preparation of a report describing i) the business activities to be performed; ii) the solvency and feasibility of the company; and iii) its economic contribution and competitiveness.

Failing to comply with any of the aforementioned requirements will cause the loss of the right to apply the special tax regime of ZEC entities.

### 4.1.2 Incorporation of the ZEC entity and inscription in the Official Register of ZEC entities

Companies that opt to apply for the ZEC regime must obtain previously an authorization of the Governing Board of the ZEC; in this sense, the procedure to obtain the authorization begins at the request of the entity which files in the offices of the ZEC Consortium the following

documentation:

- Application requesting the authorization and a report describing certain aspects of the ZEC entity that is going to be incorporated.
- Receipt proving that a deposit has been paid or a guarantee has been constituted, for the amount of the inscription fee in the Official Register of ZEC entities.

When the authorization is granted it will be notified in written within a maximum period of two months, counting after the date of filing the application in the Consortium.

Once the authorization from the Governing Board is obtained, the entity will be able to inscribe in the Official Register of ZEC entities, following the payment of the fee, and filing the following documents:

- Application requesting the inscription in the Official Register of ZEC entities.
- Tax identification number.
- Any document that proves that the company has been duly incorporated, as well as a copy of the deed of incorporation filed before the Mercantile Register.

### 4.1.3 Tax advantages of the ZEC regime

In the following sections it will be described the tax benefits of the ZEC regime regarding each one of the taxes mentioned:

## Corporate Income Tax

As a general rule, the tax rate of application in Spain was established, since fiscal year 2008, at 30percent (25percent for small-sized companies). Whereas for ZEC entities, the tax rate regarding the Corporate Income Tax has been established at 4percent, although this reduced rate will be applied to a limited amount of the taxable base, which varies depending on the employment creation and the sort of business activity developed by the ZEC company.

| Net job creation | Manufacturing Activities | Services | Other services |
|---|---|---|---|
| Between 3 and 8 employees | 1,800,000 € | 1,500,000 € | 1,125,000 € |
| Between 9 and 12 employees | 2,400,000 € | 2,000,000 € | 1,500,000 € |
| Between 13 and 20 employees | 3,600,000 € | 3,000,000 € | 2,250,000 € |
| Between 21 and 50 employees | 9,200,000 € | 8,000,000 € | 6,000,000 € |
| Between 51 and 100 employees | 21,600,000 € | 18,000,000 € | 13,500,000 € |
| More than 100 employees | 120,000,000 € | 100,000,000 € | 75,000,000 € |

It will be understood that 'other services' comprises the following activities: retail, wholesale, and mediators (with the exception of motor vehicles and motorcycles); travel agencies, wholesale and retail tourist agencies and other activities related to tourism; computer related activities; legal counselling, accounting, bookkeeping, tax advisory services, market analysis, surveys; counselling on management and administration of businesses; management of portfolio companies, advertising and public relationship.

In addition, ZEC entities will be able to apply the Double Taxation Treaties signed by Spain, as well as the Parent-Subsidiary EU Directive. On the other hand, if the parent company of the ZEC entity is a Spanish company, it will not qualify for the tax credit for double taxation of dividends or capital gains generated within Spain.

On the other hand, for fiscal years started after the 1st of January of 2007, ZEC companies that increase their capital, or at the moment of their constitution, can be used as a valid investment for RIC compromises of their shareholders, provided that certain requirements are met, among others, that the ZEC company makes the investment in certain fixed assets, and that a minimum percentage of 10percent of the capital is held by a company that is not interested in RIC investment, and that the minimum amount of the capital increase is 750,000 €.

We set forth below a case example which compares the taxation in the Corporate Income Tax of a ZEC company against a company that applies the general regime of Corporate Income Tax.

*Example: A ZEC company, that performs an activity of services included in the list of ZEC activities, and that has 6 employees, obtains a profit of 2,000,000€. Its taxable base in the Corporate Income Tax is 2.000.000€. We calculate its gross tax payable which is compared to the one obtained by a company that is non established in the Canary Islands and which cannot apply the ZEC regime (and there are not other tax credits available):*

| Example which compares the taxation in the Corporate Income Tax of a ZEC company against a company that applies the general regime of Corporate Income Tax | | | |
|---|---|---|---|
| **ZEC Company** | | **Non ZEC Company** | |
| Profits | 2,000,000 | Profits | 2,000,000 |
| Taxable Base (TB) | 2,000,000 | Taxable Base (TB) | 2,000,000 |
| TB taxed at 4% (6 employees and develops service rendering activities, there is a limit of 1,5 MM € to the 4%) | 1,500,000 | | |
| TB taxed at 30% | 500,000 | TB taxed at 30% | 2,000,000 |
| Tax payable at 4% | 60,000 | | |
| Tax payable at 30% | 150,000 | Tax payable at 30% | 600.000 |
| Total tax payable | 210,000 | Total Tax Payable | 600,000 |
| Net ZEC advantage | 390,000 | | |

## General Indirect Canary Tax (IGIC)

ZEC companies are exempt from IGIC for the sale of goods or rendering of services made for or by ZEC entities between them, and for the import of goods made by ZEC entities.

Furthermore, companies that have applied for this special tax regime, will have the right to deduct and request the refund of the IGIC quotes borne in the acquisition of goods, services perceived, or the implicit tax burden borne, as well as the IGIC tax gross payable paid to the Tax Office of the Canary Islands, insofar the goods and services are used by the taxpayer in the development of the activities mentioned before.

## Transfer tax and stamp tax

ZEC entities will be exempt from taxation in the following cases:

- For the acquisition of goods and rights used for the development of the activity of the ZEC entity within the geographical field of ZEC companies.
- For mercantile operations made by ZEC entities, except its dissolution.
- For the documents subject to stamp duty regarding operations made by ZEC entities within its geographical field (notary deeds or testimonies) with the exception of bills of exchange.

## Double taxation treaties, Parent-subsidiary Directive, and the Non Residents Income Tax

- ZEC entities can apply the Double Taxation treaties signed by Spain.
- ZEC entities will be able to apply the Parent-Subsidiary Directive of the European Union, which means that dividends paid by ZEC entities to its parent companies, provided that they are resident in other countries of the EU, might be exempt from withholding in Spain.
- ZEC regulations grant the following tax exemptions to the income obtained by tax residents of non-EU countries, when such income is paid by ZEC entities as a result of operations performed material and effectively within the geographical area of the ZEC entity:
    - Individuals: interests and other returns obtained for the loan to third parties of capital, as well as the capital gains deriving from movable property, obtained without a permanent establishment.
    - Companies: the profits distributed by the subsidiary companies that are resident in Spain to their parent companies.

These exemptions will not be applied when the income is obtained through a tax haven or through territories with which there is not an effective exchange of tax information, nor when the parent company has its tax residency on any of the aforesaid countries or territories.

## *4.2 Special Register for Ships and Shipping Companies (REB)*

This is a tax incentive conceived to improve the competitiveness of the shipping activities located in the Canary Islands, as well as the ports in the Canaries, thanks to the tax exemptions and tax benefits granted to the shipping companies and ships that are registered in the REB.

### 4.2.1 Tax benefits of the REB

The tax benefits are related to the following taxes:

## Transfer tax and stamp duty

Contracts and other legal acts executed over ships registered in the Special Register, which are subject to the Transfer tax and stamp duty tax will be exempt from taxation.

## Personal Income Tax and Non Residents Income Tax

- Crew members of the ships inscribed in the REB, which are taxpayers of the Personal Income Tax, will have a 50percent exemption on their income deriving from salaries, which have been generated during the navigation made in ships inscribed in the said Register.
- Crew members of the ships inscribed in the REB, which are taxpayers of the Non Residents Income Tax, will have a 50percent exemption on their income deriving from salaries, which have been generated during the navigation made in ships inscribed in the said Register.
- Nevertheless, when the ships are assigned to regular services of passenger transport between ports of the European Union, the exemptions mentioned previously will be applied only to the crew members that are citizens of any of the countries which are members of the European Union or any of the countries that belong to the Agreement on the European Economic Space.

## Corporate Income Tax

There will be a reduction in 90percent of the gross tax payable of the Corporate Income Tax, after applying the deductions for double taxation internal and international, which corresponds to the apportion of the taxable base that proceeds from the business exploitation developed by the shipping companies related to the services rendered between the Canary Islands and between the Islands and the rest of the Spanish territory, by their ships duly inscribed in the Special Register.

## ZEC entities

Shipping companies that had been constituted as ZEC entities will not apply the REB regime, but the ZEC regime.

## Special taxes

The first definitive register of a ship before the Special Register of ships and shipping companies will not be subject to the Special tax on certain ways of transportation.

## Social Security contributions

There will be a reduction in 90percent in the contributions to the Social Security borne by the shipping companies, regarding the crew members of ships registered in the Special Register.

### 4.2.2 Procedure of inscription in the REB

Ships and shipping companies will be able to obtain their inscription in the Special Register when the following requirements are observed:

- Shipping companies that have in the Canary Islands their effective control centre, or which, located in the rest of Spain or in a foreign country, have a permanent representation in Spain, through which exercise their rights and meet the obligations observed by the Laws of application.
- For the inscription of shipping companies, it will only be needed a copy of their certificate of inscription in the Mercantile Register showing that their corporate purpose includes the economic exploitation of merchant ships under any category that guarantees the availability of the whole ship.

These companies can apply for the inscription in the Special Register when the following requirements are met:

- Ships: any merchant ship apt for navigation with a mercantile purpose, excluding fishing boats, even if the ships are under construction.
- The minimum size of the ships must be 100 GT.
- Possession title: shipping companies must be the proprietors or financial lessees of the ships whose inscription is applied for; or at least must have the possession of the ships under a bareboat lease contract or other contract that implies a full control of the nautical management and commercial activity of the ship.
- Condition of the ships: ships that proceed from other registers, which pretend their inscription in the Special Register must justify that they meet the security measures established by the Spanish legislation and the International Treaties subscribed by Spain, and they can be submitted to an inspection prior to their inscription in the Special Register,

in the terms determined by the Ministry of Transports and Public Works.

Prior to the inscription of a ship in the Special Register, its owner must file a document that proves the payment of customs duties, if the ships are imported.

Crew members and shipping companies which are assigned to regular transport services between the Canary Islands, and between the Canary Islands and the rest of Spain, insofar the ships cannot access to the Special Register, will be able nevertheless to apply the exemptions in the Stamp Duty and Transfer Tax, Personal Income Tax, and Non-Resident Income Tax, and the reductions in Social Security contributions, which are explained below.

When the regular services mentioned before are passenger transport services, the exemptions and reductions will only be applied to crew members that are nationals of any country member of the European Union or any of the or any of the countries that belong to the Agreement on the European Economic Space.

## *4.3 The Customs-free Area of Gran Canaria*

The Customs-free area of Gran Canaria is an enclave located within the customs area, fully delimited, where it is possible, without a time limit, to store, transform and market goods, without levying customs duties, nor other indirect taxes.

### 4.3.1 Tax Advantages of the regime

Companies established within the Customs-free area of Gran Canaria enjoy the following specific tax and customs benefits:

- Exemption of payment of customs duties when the goods are introduced in the area.
- Exemption of payment of indirect taxes in the processes of preparation of the goods, such as labelling, packaging, re-packaging, previous to its departure.
- Possibility of being a ZEC company.
- Possibility of applying the RIC tax benefit in the Corporate Income Tax.
- Exemption in the payment of transfer tax and IGIC-VAT in investment assets.

### 4.3.2 Requirements to apply for this regime

The main business activities allocated in customs free areas are related to logistic store and international distribution of goods, transformation processes applied on raw materials of non European origin, and certain assembly and manufacturing processes based on fishing,

agricultural and farming, and manufacturing of high value and reduced size goods.

## Which requirements must be met to apply this regime?

Any company that it is interested in establishing in the Customs-free area of Gran Canaria will have to file a project for its authorization by the Plenary of the Consortium, accompanied by certain documents.