TAX SYSTEM **and** ADVANTAGES **in** **Gran Canaria**

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A. TAXATION OF COMPANIES

A.1 RESIDENT COMPANIES

A company is resident in Spain and subject to Corporate Income Tax (CIT) on its worldwide income when:

- it has been incorporated in accordance with Spanish law
- its registered office is in Spain, and/or
- its ‘effective’ head office is in Spain.

Under Spanish law, a company’s ‘effective’ head office is in Spain when its business activities are managed and controlled from Spain.

Companies established in a country or territory where no tax is levied or that is a tax haven are deemed to be tax resident in Spain in the following cases:

- When the company’s main assets consist, directly or indirectly, of property located or rights fulfilled or exercised in Spain.
- When the company’s core business activity is carried on in Spain.

This presumption may be refuted by the company if it can prove that it is effectively administered and managed in the country or territory in which it is established and that it was incorporated and operates for valid economic and business reasons and not merely for the purpose of managing securities or other assets.

Permanent establishment (PE)

Taxpayers operating in Spain through a PE are subject to Non Resident Income Tax (NRIT).
For NRIT purposes, most Spanish tax treaties for the avoidance of double taxation contain a definition of PE in line with Organization for Economic Co-operation and Development (OECD) criteria.

However, in the absence of a tax treaty, internal law states that an individual or company is considered to operate through a PE when, by any legal means, one has continuous or habitual work facilities in Spain or a place to do any kind of work where one performs all or part of one’s activity, or when one acts in Spain through an agent with powers to enter into an agreement in the name and on behalf of the non-resident individual or company, provided said powers are exercised on a regular basis.

In particular, management offices, branches, offices, factories, workshops, warehouses, shops or other establishments; mines, oil or gas wells, quarries, farms, forestry facilities, livestock farms, or any other site where natural resources are collected; and construction, installation, or assembly sites whose duration lasts more than six months will be considered PEs.

It should be noted that the Spanish High Court has issued several judgements and is adopting a functional approach to the subject of the existence of a PE. In this regard, it has afforded a flexible interpretation of what has to be considered a PE, and specifically, of the concepts of dependent agent and fixed place of business.

A.2 CORPORATE INCOME TAX

A.2.1 Tax rate

The general CIT rate in Spain is 25%. Other tax rates may apply, depending on the type of company that is taxed and the type of business carried out. Resident companies are taxed on their worldwide income.

For permanent establishments (PEs) in Spain of foreign companies, non-resident income tax (NRIT) is chargeable on income that may be allocated to the PE at a 25% tax rate. Furthermore, NRIT is also chargeable on non-established foreign companies/individuals that obtain income in Spain.

Small companies

Companies with a turnover under EUR 10 million in the preceding tax year (considering, in the case of a group of companies, the group companies' total turnover) are considered small companies for CIT purposes and are taxed at the general 25% tax rate

Newly created companies

Newly created companies are taxed at a 15% tax rate for tax periods starting on or after 1 January 2015, provided that they have been set up after that date, for both the first tax period in which they obtain a profit and the following tax period. This tax rate is not applicable to companies that, by law, are considered equity companies or to newly created companies that are part of a national or international group.

The reduced rate may also be inapplicable if such business activity was previously carried out by a related entity or individual.

Newly created companies that are set up in tax periods starting prior to that date will continue to be taxed at a 15% tax rate on their tax base up to EUR 300,000 and a 20% tax on any excess in these two periods.

A.2.2 Income determination

The general rule for determining income for CIT purposes is that accounting rules must be followed unless tax law establishes otherwise. In order to maintain this consistency, CIT/PE NRIT returns include pages in which the company's accounting/commercial balance sheet and profit and loss account figures must be entered.

In Spain, the tax authorities are authorised to modify accounting results exclusively for the purpose of determining tax results if they observe that a company's accounting results have not been calculated in accordance with Spanish Generally Accepted Accounting Principles (GAAP).

Inventory valuation

Inventory is valued at acquisition price or production cost under the average and first in first out (FIFO) valuation methods (the replacement and base stock valuation methods may only be used in exceptional cases). Again, since there are no specific tax rules for determining taxable income, accounting rules are also applicable for calculating valuation and obsolescence provisions for inventory.

Capital gains and losses

Capital gains are taxable in the tax year in which they arise. They are treated as normal income and taxed at the standard CIT rate of 25%.

For operations where payment is deferred or paid in instalments, the income is obtained proportionally as the corresponding payments are made, unless the taxpayer opts to be taxed in accordance with the accrual criteria.

As a general rule (there are certain exceptions), capital gains arising on the transfer of companies resident in Spain in which at least a 5% interest (or an interest with an acquisition value of over EUR 20 million) has been held for at least one year are exempt from tax. The period during which the interest is held by another group company is also taken into account for this rule.

Capital losses arising from the transfer of shares will only be tax deductible if they relate to shareholdings of less than 5% (with a cost of less than EUR 20 million) and, in the case of holdings in the capital or equity of non-resident entities, the investee entity has been subject to and is not exempt from a foreign tax identical or analogous in nature to CIT at a nominal rate of, at least, 10% or is resident in a country with which Spain has concluded a double tax treaty (DTT), and it contains an exchange of information clause.

Negative income generated in the event of the extinguishment of the investee entity will, in any event, qualify for deduction for tax purposes unless such extinguishment results from a restructuring operation.

In such cases, the negative income will be reduced by the amount of the dividends received in the ten years prior to the date of extinguishment, unless such dividends have reduced the acquisition value, and provided that they qualified for the application of an exemption or deduction regime for the elimination of double taxation for the same amount. Tax losses generated on transfers of assets to another company in the same corporate group are not tax deductible when the transfer takes place. Their tax deductibility is deferred to the moment when the assets are written off the acquirer's balance sheet transferred out of the group or when the transferor or acquirer cease to form part of the group. In the case of depreciable/amortisable assets, however, the undeducted amount should be included in line with its depreciation/amortisation by the acquirer.

Dividend income

Dividends received from companies resident in Spain in which at least a 5% interest has been held for at least one year, including ownership by other group companies, (or with an acquisition value of over EUR 20 million) are exempt from tax. Dividends received from companies resident in Spain in which an interest of less than 5% is held (and with an acquisition value of less than EUR 20 million) are taxable in their entirety for the recipient.

Special rules apply to, amongst others, the following:

- Dividends received from companies that obtain dividends or capital gains generated from transfers of interests in other companies, provided that such dividends and capital gains exceed 70% of the company's gross income.

- Capital gains arising from transfers of interests in companies that receive dividends or capital gains generated from transfers of interests when such dividends and capital gains exceed 70% of the company's gross income.

Stock dividends

CIT is not levied on bonus shares (i.e. shares partially or totally given to shareholders in a capital increase charged against distributable reserves), although they must be taken into account when calculating the average cost of shares held for the levying of tax when the shares are sold.

Interest income

Interest income is treated as normal income and taxed at the standard CIT rate of 25%.

Royalty income

Royalty income is included in the taxable base jointly with the other kinds of income.

However, a 60% reduction may be applied on the net income obtained from licensing certain intangible assets if certain requirements are met (the effective tax on this net income would generally be 10%).

Effective as of 1 July 2016, the rules to calculate the patent box tax incentive have been modified to bring this tax incentive in line with the EU and OECD Agreement. With this reform, income generated from assigning the use of certain intangible assets may be eligible for a reduction in the taxable base of the percentage resulting from multiplying by 60% a coefficient that may not be greater than one (i.e. the maximum reduction will be 60%).

Other significant items

The following items, amongst others, are excluded or deferred from taxable income:

- Distributed dividends corresponding to profits obtained by companies in tax periods in which the flow-through tax regime (internal and international) has been applied.
- Assets written up in accordance with revaluation laws and tax-protected restructuring transactions involving accounting capital gains.

Foreign income and tax relief

Resident companies are taxed on their worldwide income. For foreign-source income, total or partial tax relief in the form of tax credits or exemptions is given if tax is levied on the income in both Spain and the foreign country where the income has been generated.

This tax relief may be available for the following:

- Economic double taxation, which is when the same income is taxed in the hands of two different taxpayers. For example, another government taxes a foreign company on the income earned in that country and a Spanish resident shareholder is taxed on the dividends that it receives from the foreign company or the capital gains from transfers of its shares.
- Juridical double taxation, which is when the same income is taxed in two countries in the hands of the same taxpayer. For example, the income is taxed (via a WHT) in the country where the income is generated and again in the other country where the recipient is resident.

Dividends or profit-sharing income received by a Spanish company from a foreign company are tax exempt, subject to compliance with the following requirements:

- The Spanish company has at least a 5% interest in the foreign company (or an interest with an acquisition value over EUR 20 million) that has been held for at least one year. This one-year holding period is deemed to be complied with if it is completed after the dividend is distributed. The period in which the interest is held by another group company is also taken into consideration for this rule.

- The investee has been taxed by a tax that is identical or similar to Spanish CIT at, at least, a 10% nominal tax rate in the tax year in which the distributed profits were obtained. This requirement is complied with when the investee is resident in a country with which Spain has signed a tax treaty containing an exchange-of-information provision.

- The tax exemption would not apply with respect to the amount of dividends or profit sharing whose distribution generates a tax deductible expense in the paying entity.

Capital gains arising from the sale of shares in foreign companies also qualify for a tax exemption if the requirements stated above are complied with during the holding period.

Both the dividends and capital gains exemptions are not applicable when the investee company is resident in a tax haven, unless it is an EU member state and the company can prove that it has been incorporated and operates for valid business reasons and that it carries on business activities.

Tax exemption is limited in certain cases.

Special rules apply to, amongst others, the following:

- Dividends received from companies that obtain dividends or capital gains generated from transfers of interests in other companies, provided that such dividends and capital gains exceed 70% of the company's gross income.

- Capital gains arising from transfers of interests in companies that receive dividends or capital gains generated from transfers of interests when such dividends and capital gains exceed 70% of the company's gross income.

As an alternative to this 'tax exemption' regime and applicable to dividend distributions only, a tax credit based on imputation is established. This tax credit allows the crediting of the foreign tax paid abroad on the income from which the dividends are paid and the foreign WHT paid on the profit distribution, up to the limit of the tax that would have been paid on the gross amount in Spain. The only requirement for the application of this 'tax imputation' regime is that the Spanish company has at least a 5% interest in the foreign company during the 12 months prior to the date on which the dividend is due and payable. This one-year holding period is deemed to be complied with if it is completed after the dividend is distributed. The tax credit can be carried forward for an unlimited number of years.

Spanish legislation provides for CIT relief on 'juridical' double taxation by applying the 'tax imputation' regime. Under this regime, gross foreign income (including foreign WHT paid) is included for Spanish tax calculation purposes, and a tax credit for the foreign WHT paid is applicable up to the amount of the CIT that the company would have paid if such gross income had been obtained in Spain. The part of the tax paid abroad with respect to which the taxpayer is not entitled to this tax credit may be considered tax deductible, provided that it corresponds to the foreign company's business activities carried out abroad. The tax credit can be carried forward for an unlimited number of years.

Under Spanish tax treaties and implemented EU tax directives, several methods have been established to avoid double taxation. The main one is the traditional deduction of a tax credit from tax effectively paid. However, some treaties establish a tax exemption or the exclusive right to tax. Also, a tax-sparing clause is included in some treaties, which allows for the deduction of not only the tax actually paid but a higher amount of tax.

A.2.3 Tax credits

No specific tax relief is established in Spanish law for foreign investors. Relief may be availed of by Spanish and foreign-owned companies alike. The tax relief available under CIT law in Spain is as follows.

Most of the tax credits that have been established to promote certain investments have been eliminated. However, the largest tax credits are maintained (tax exemption/deduction credit to prevent internal and international double taxation, tax credit for R&D, and tax credit for technological innovation). In this sense, investments in Spanish feature-length film productions and the production of audiovisual fiction, animation, or documentary series entitle the application of important tax credits.

Due to the remoteness and isolation of the Canary Islands, they have traditionally enjoyed a special economic and tax regime with specific economic and tax measures different to those established for the rest of Spain. As a result, they have one of the most profitable tax regimes in Europe.

Most Spanish CIT deductions are 80% higher for companies and businesses located in the Canary Islands (the tax credit is increased by at least 20 percentage points).

A.2.3.1 Reserver for Investments in the Canary Islands (RIC)

This tax incentive is applicable to legal entities subject to the CIT, with PE in the CI (it is also possible to apply to non-resident entities in Spanish territory operating in the Canary Islands by a PE), which closes the trade cycle.

In this regard, companies are entitled to a reduction in the taxable amount of the CIT in each tax period for the allocations made to the Reserve for Investments in the Canary Islands (RIC, hereinafter), this reduction is limited to 90% of the undistributed profits of the period and which correspond to their establishments located in the islands.

The precise requirements for the practice of the tax benefit for the companies are basically the followings:

- Authorized investments. The amount destined to the RIC must materialize in initial investments or to continue the activity.

- Situation and use of assets. The assets in which the investment materializes must be located or be received in the CI, used in it, be affected and be necessary for the development of economic activities of the taxable entities.

- Terms of materialization of the reservation. The investment of the amounts destined to the RIC must be made within 4 years since the end of the FY corresponding to the reduction which is applied. The investment is understood to be performed when the assets come into operation.

- Maintenance of investments. Assets considered to be initial investments must remain operational in the enterprise for at least 5 years without being transmitted, leased or transferred to third parties for use.

- Posting of the reservation. The RIC must be included in the balance sheets of the company with absolute separation and appropriate title, being unavailable as long as the assets in which it had materialized must remain in the company.

A.2.3.2 Deduction for New Fixed Assets

The system of deduction for investments in the Canary Islands is the common one of the CIT Law started in 1978, however, the rates of deductions are considerably higher.

In this sense, the applicable deduction rate is 25% of the value of the acquisition of the assets. According to the law the goods have to remain in operation in the company during five years, except that it's useful life is inferior according to the amortization method.

In this regard, the basis of the deduction will be the acquisition price or the production cost.

A.2.3.3 Regime for entities manufacturing tangible goods

In this regard, a CIT deduction of the tax quota corresponding to the income derived from the sale of tangible goods produced by the seller in the Canary Islands is applicable. The deduction amount is 50%.

A.2.3.4 R&D and technological innovation credits

The deduction rates which are applicable are:

	Canary Island	Mainland Spain
I+D	**45%**	**25%**
	(+) 37% Full time researchers salaries	(+)17% Full time researchers salaries
	(+) 30,6% Excess over last two years average expenses	(+) 17% Excess over last two years average expenses
	(+) 28% Equipment investments	(+) 8% Equipment investments
IT	**45%**	**12%**

Tax relief for R&D and technological innovation can be excluded from the limits on tax relief applied on tax liabilities, which will have a cost of 20% of the tax relief applied, meaning that, if certain requirements are met, 80% of the tax relief for R&D and technological innovation may reduce tax liability after double tax deductions and tax allowances to zero, and any excess tax relief (up to its 80%) may be refunded by the tax authorities.

The requirements for the exclusion of the R&D and technological innovation tax reliefs from the tax relief limits are as follows:

One tax period has passed since the tax relief was generated and the tax relief has not been applied.

An amount equal to the tax relief applied or paid has been allocated to R&D and technological innovation expenses or to investments in tangible fixed assets or intangible assets used exclusively for R&D and technological innovation activities, excluding real property, within 24 months of the end of the tax period when the tax relief was applied or paid.

The taxpayer's average number of staff (staff in general or staff assigned to R&D and technological innovation activities) has not decreased between the end of the tax period when the tax relief was generated and the end of the reinvestment period.

The taxpayer has a report that certifies that the activities are R&D and technological innovation activities or it has made an advance agreement with the Spanish tax authorities regarding the valuation of the expenses and investments of the project.

The following should also be taken into consideration:

- The tax relief applied or paid for technological innovation in accordance with the foregoing comments may not exceed a total of EUR 1 million per year.

- The sum of the tax relief applied or paid for technological innovation and the tax relief applied or paid for R&D innovation in accordance with the foregoing comments may not exceed a total of EUR 3 million per year.

If R&D expenses for the year exceed 10% of turnover, an additional amount of EUR 2 million per year of tax credit for R&D can be applied or paid without limitation and with a 20% discount.

On the other hand, the R&D tax incentives which are applicable in the Canary Islands are considerably stronger than that, which is applicable in the Spanish mainland.

The limit of application in quota of the deduction for R+D+I activities is 90% in the Canary Islands (50% in the Spanish mainland) of the quota in the case where the deduction for the R+D+I activities of the financial year exceeds 10% of the amount of the total reduced fee Gives. In another case, this limit will be 60% in the Canary Islands (25% in the Spanish mainland).

Notwithstanding the foregoing, by fulfilling certain additional requirements, the taxpayer may compensate (apply), until exhausted, the full quota reduced with credited R+D+I reduction remnants, discounted at 20% and even request the return amounts of such deduction of R+D+I discounted.

A.2.3.5 Tax credits for film productions and live performing arts and musical shows

Through the existence of the aforesaid REF, validated by the Spanish and European national regulations, the Canary Islands enjoy a special and special legal-fiscal framework that allows productions to benefit from the following tax deductions.

a) International productions

Producers with fiscal residence in the Canary Islands and who are responsible for the execution of a foreign production (production service companies) benefit from a deduction of 40% of the eligible expenditure in the Canary Islands. This incentive may not exceed 4.5 million euros, in mainland Spain the deduction may not exceed 3 million.

The foreign productions of cinematographic feature films that allow the preparation of a physical support prior to their serial industrial production may benefit from this deduction. Therefore, feature films, animation films, fiction series and documentaries are included. In this regard, the minimum expenditure in the Canary Islands related to post-production activities and animation films must exceed 200.000 euros, whilst in Mainland Spain such amount must exceed 1 million euros.

The tax deduction amount (40% of the eligible expenses) is deducted from the corporate tax quota from the tax period in which the production service ends.

	Canary Island	Mainland Spain
DEDUCTION PERCENTAGE	**40 %** of the eligible expenditure in the Canary Islands[1]	**20 %** of the eligible express
LIMIT OF THE DEDUCTION	**5.400.000,00 €**	3.000.000,00 €
LIMIT OF THE DEDUCTION BASE	11.250.000,00 €	15.000.000,00 €

[1] Eligible expenses must ascend to 1.000.000,00€ as a minimun

b) Spanish productions or co-productions

In the case of national productions that are developed in the Canary Islands and that obtain the Canary Work Certificate, the deduction percentages are 45% on the first million of euros, and 40% thereafter. This incentive is limited to a maximum deduction of 5.4 million euros, being the deduction in mainland Spain of 3 million. They will be able to benefit:

- Feature films for cinema
- Audiovisual fiction, animation or documentary series

The tax deduction amount is the tax credit that is deducted from the corporate tax (IS). If there is not enough fee to apply the entire deduction, the remaining balance can be deducted from the installments in the IS of the following years.

Regarding the deductions for investments in productions of feature films and audiovisual series of fiction, animation or documentary in the Canary Islands, the limits are higher than those established in the state regulations.

	Canary Islands	Mainland Spain
DEDUCTION PERCENTAGE	**45 %** on the first million of euros	25 % on the first million of euros
	40 % thereafter	20 % thereafter
LIMIT OF THE DEDUCTION	**5.400.000,00 €**	3.000.000,00 €
LIMIT OF THE DEDUCTION BASE	13.375.000,00 €	14.750.000,00 €

A.2.3.6 Investments in Africa and marketing expenses

The entities whose net amount of turnover in the immediately preceding tax period is equal to or less than 10 million euros and with an average workforce of less than 50 people in said period will be entitled to practice the following deductions from the full quote.

In the case of the investments in Africa it will be able to practice a deduction of 15% in the CIT a company that make investments in the incorporation of subsidiaries or permanent establishments in Africa (Morocco, Mauritania, Senegal, Gambia, Guinea and Cape Verde) provided that certain requirements established in Law 19/1994 are met.

On the other hand, the entities can apply a deduction of 15% of the amount paid for marketing and advertising expenses for launching products, opening and prospecting markets abroad and attending trade shows, exhibitions and similar events.

These deductions will amount to 10% when, not meeting the requirements, the aforementioned net amount of turnover does not exceed 50 million euros and the average staff is less than 250.

The deduction of the investments in Africa will be applied in the tax period in which the entity which is participed or the permanent establishments start the economic activity, and it is subject to an increase in the average taxpayer staff in the Canary Islands in this tax period compared to the average workforce existing in the previous tax period and to the maintenance of it over a period of 3 years.

A.2.3.7 Reserve for levelling-off of tax losses

The possibility of reducing the positive tax base of small companies by up to 10% by establishing a non-distributable reserve for the amount of the reduction is introduced (reserve for the levelling-off of tax losses). The reduction may not exceed EUR 1 million and should be reversed in line with the tax losses obtained by the company, subject to a five-year time limit.

A.2.4 Limits on the application of tax credits.

Limits on the amount of tax credit applied

The combined sum of all investment tax credits may not exceed 25% of the company's gross tax payable less deductions for international double taxation. When R&D and technological innovation tax credits for expenses and investments in the year exceed 10% of the company's gross tax payable, less tax credits and relief mentioned above, the limit will be 50%.

In addition, a limit of 50% of gross tax payable is established for the application of deductions for international or internal double taxation (generated or pending application). This limit will only apply to companies with a net turnover of at least EUR 20 million.

In the Canary Islands, the limits are wider, hence the tax quota can be completely offset using the following rules:

- Deductions generated in the same fiscal year: up to 50% of the tax quota
- Deductions generated in previous fiscal years: up to 70% of the tax quota

The combination of both compensations can involve full cancellation, although the deductions of each previous year cannot be higher than 50% of the tax quota, regardless the addition of all the deductions of previous years amounts to 70& of the tax quota.

Time limits for the application of tax credits

Tax credits that are not applied in the tax period owing to insufficient tax payable may be applied in tax periods ending in the 15 years immediately thereafter. However, R&D and technological innovation tax credits may be applied in tax periods ending in the 18 years immediately thereafter, and tax credits for the avoidance of double taxation may be applied in the ensuing tax periods with no time limits.

A.2.5 Tax period

The tax year for CIT purposes is the company's accounting year. The tax year cannot exceed 12 months. Incorporation, change of accounting year, or dissolution of a company can give rise to a period of less than one year.

A.2.6 Tax returns

The tax system in Spain is a self-assessment system, and tax returns may be inspected by the tax authorities.

Annual CIT returns must be filed within 25 calendar days following the six months subsequent to the end of the tax year (i.e. if the tax year coincides with the calendar year, the return must be filed between 1 July and 25 July of the following calendar year).

A.2.7 Advance payments

For CIT, three advance payments of the annual tax payment must be made during the first 20 calendar days of April, October, and December. The final CIT payment must be made with the annual CIT return.

For companies whose turnover, in accordance with Spanish VAT law, for the 12 months prior to the beginning of a tax period exceeds EUR 6,010,121.04, the advance payments are calculated by applying 17% to the taxable income (reduced by any applicable tax-loss carryforwards) for each advance-payment period, i.e. at 31 March, 30 September, and 30 November (percentage applicable to companies that are taxed at the general CIT rate).

Small and medium-sized companies can opt to calculate their advance payments in the same way as large companies (applying a percentage of 17%) or to apply a rate (currently 18%) on the tax liability of their last advance CIT return filed on 1 April, 1 October, or 1 December.

Variable capital investment companies, financial investment funds, real estate investment companies, real estate investment funds, mortgage market regulation funds, and pension funds that meet certain requirements and are taxed at a 1%, or even a 0%, tax rate should not make advance payments and are not required to file the corresponding tax return.

A.3 WITHOLDINGS

Ordinarily, WHT is the mechanism by which the Spanish tax authorities collect the final tax levied on non-residents.

Below are the domestic withholding tax rates applicable to the main types of income remitted to non resident entities. Such withholding tax rates may be reduced or mitigated under the provisions of an applicable Double Tax Treaty signed by Spain and the relevant country, or by the Spanish implementation of a European Union Directive.

Dividends

Dividends distributed to non-resident entities are subject to 19% withholding tax. However, the implementation of the EU Parent-Subsidiary Directive in the Spanish law provides shareholders resident in the EU with a WHT exemption on dividends received from Spanish companies, if certain requirements are met.

Interest and some other returns from moveable goods paid by companies under this tax regime are exempt from Spanish NRIT, except when paid to residents in tax havens.

Benefits established in the EU Parent-Subsidiary Directive are extended to non-EU residents. These benefits are not applicable when the income is paid to residents in tax havens.

Interests

Interest paid to non-resident entities is subject to 19% withholding tax. Furthermore, interest paid to an entity resident in the EU may be reduced to 0%.

Royalties

A 24%, or 19% in case of entities resident in EU Member State, WHT rate is levied on royalty payments made to non-resident entities. Furthermore, royalties paid to an associated entity resident in the EU may also be reduced to 0% if certain requirements are met.

A.4 CANARY ISLAND SPECIAL ZONE TAX REGIME

The main advantage of this group of tax incentives is that, whilst the general CIT regime establishes a 25% tax rate for Spanish companies, **the ZEC tax rate applicable to the valid ZEC tax base amounts to 4%.**

In January 2000, a Canary Island Special Zone tax regime (ZEC) was approved by the European Union. The main regulations of this regime, established by the Spanish government, are as follows.

New companies and branches may qualify for the application of this tax regime and, on the approval of the tax authorities, may be registered up to 31 December 2020 (applying the tax regime up to 31 December 2026). This may be extended by the European Union.
The application of the ZEC regime by branches which belong to companies which take part in tax consolidated groups does not entail the exclusion of such companied of the aforesaid tax consolidated groups, in such a way that the benefits obtained by the branch must be declared in a separate Corporate Income Tax return.

To qualify for this tax regime, the company must: (i) covenant to make an investment in fixed assets of at least EUR 100,000 in Gran Canaria or Tenerife, or EUR 50,000 in Fuerteventura, Lanzarote, La Palma, El Hierro, or La Gomera, within the first two years of their business activity (ii) covenant to create at least five new jobs in Gran Canaria or Tenerife, or three in other islands (iii) provide a description of the business activities to be carried out that support the company’s solvency, viability, international competitiveness, and contribution to the economic and social development of the Canary Islands (iv) establish its registered office and place of effective management in the Special Area (v) have at least one company director who resides in the Canary Islands or a legal representative in the case of branches, and (vi) carry out one of the qualifying business activities.
Regardless of the above, the companies which do not fulfill the requirement on investment in fixed assets may apply the ZEC regime as long as the creation of jobs and the average of employees exceed the minimum which was previously indicated.

The territory where this tax regime can be applied includes all the Canary Islands and companies applying the tax regime may operate outside the Canary Islands through branches if separate accounting books are kept.

Activities for which the tax regime can be applied include a wide range of industrial and commercial activities, most services and holdings. Credit and insurance entities are excluded, and no stock exchanges are allowed.

The tax liability on which the Canary Island Special Zone tax regime will apply is determined in accordance with the following rules: (i) companies that meet the requirement of creating a minimum number of jobs may apply the special tax regime on a tax liability of EUR 1.8 million, (ii) the tax liability on which the special tax regime will be applied is increased by EUR 500,000 for each job created over the minimum threshold, up to 50 jobs. If more than 50 jobs are created, the Canary Island Special Zone tax regime will apply to the full amount of tax liability even if another limit, which in practice is not applied so often, may apply. These thresholds are considerably high and the tax relief is not usually capped.

Under this tax regime, companies can avail themselves of large tax exemptions for IGIC, transfer tax, and stamp duty, and large reductions and simplified regulations for local taxes.

Interest and some other returns from moveable goods paid by companies under this tax regime are exempt from Spanish NRIT, except when paid to residents in tax havens.

Benefits established in the EU Parent-Subsidiary Directive are extended to non-EU residents. These benefits are not applicable when the income is paid to residents in tax havens.

B. OTHER TAXES

B.1 Canary Islands General Indirect Tax (IGIC)

Although the Canary Islands are a Spanish region which has the same political status than other Spanish regions they do not belong to the Spanish VAT territory, which means the Spanish VAT law is not applicable in the Canary Islands.

The tax which is currently applicable is the Canary Islands General Indirect Tax (hereinafter IGIC), a Canarian tax which is equivalent, in many aspects, to the Spanish VAT, but which also includes important differences.

In this sense, despite the fact that the mechanism of these two taxes is the same, the tax rate of IGIC is lower than the Spanish VAT rate, being the IGIC general tax rate 7%, instead of 21% of the Spanish VAT.

This tax, is applicable on the delivery of goods and the provision of entities services, onerous, by entities and professionals on a regular or occasional basis, as well as imports of goods.

Generally, Spanish companies are considered as IGIC taxpayers. The same happens with Spanish branches of non-resident entities, which are considered as PEs for IGIC purposes, and thus, IGIC taxpayers.
In general terms, Spanish IGIC taxpayers are obliged to file IGIC returns, prepare the IGIC books for the invoice issued and invoices received and the invoices concerning the Spanish transactions should be issued including the mention indicated in the Spanish Invoicing Regulations.

The general IGIC refund system consists of the obligation to file IGIC returns quarterly. IGIC credit position in a given quarter can be offset against the IGIC quotas which are paid in the followings quarters. If at the end of the fiscal year the IGIC balance of the IGIC results in a credit position, the IGIC quotas will be refunded during the following six month period.

When the turnover corresponding to the prior year is higher than Euros 6,010,212.04 €, the Spanish branch must file the IGIC returns on a monthly basis. There is the possibility of applying for the monthly refund regime (REDEME).

B.2 Customs duties = AIEM

As we commented, although for the purposes of IGIC the Canary Islands are not part of the VAT territory, they are part of the European customs territory. In this sense, many goods imported into Spain from outside the European Union are subject to customs duties. Likewise, the goods imported into Canary Island are also subject to AIEM.

Currently it is part of the economic tax regime of the Canary Islands the contribution on Imports and Deliveries of Goods in the Canary Islands (AIEM), this is a single-phase state tax wich taxes the deliveries of goods manufactured in the Canary Islands by the producers of such goods, as well as imports of similar goods belonging to the same category defined by reference to the Common Customs Tariff nomenclature. The goods that are subject to this tax are described in the Annex I of the Law 4/2014, of 26 Juny.

It states the proportional rates of 5, 10, 15 or 25%, as well as the specific type corresponding to petroleum-based products. In the case of cigarettes, a minimum type of specific character is established. However, most of the products which are manufactured inside the Canary Islands are exempt of this tax.

B.3 Duty Free Zones

According to the EU Customs Code, Duty-Free Zones are a portion of the EU Customs Territory, adjacent to maritime ports and airports, where the goods which are imported can be stored (without time limits), transformed and distributed.

These operations can be performed without the application of customs duties, excise duties nor other indirect taxes. Likewise, nor quotas nor restrictions are applicable, and the supply of components from other countries is fully guaranteed.

Other advantages are also applicable, like the simplification of the customs procedure. It avoids the submission of a previous customs declaration, streamlines the management and expedites the business answers.

B.4 Excise duties

Excise duties are chargeable on most hydrocarbon oil products, alcoholic drinks, and tobacco products imported into or produced in Spain, being in all the cases lower than the rates in the mainland Spain.

B.5 Transfer Tax

A transfer tax, whose rate varies between 1% and 7% (depending on the operation) is generally levied on inter vivos transfers and second and ulterior transfers of buildings between entities. Consequently, first real estate transfers are subject to IGIC.

B.6 Stamp dutty

The following documents are subject to the tax on documented legal acts:

- Notarial documents (e.g., the first copies of public deeds and notarial acts) when they are intended for an economically measurable amount or thing, which may be registered in a public registry and the operation is not subject to the other Tax or inheritance and donations tax modalities.
- Commercial documents (e.g., letters of exchange and documents with spin function).
- Administrative and judicial documents (e.g., the preventive annotations of embargo).

For notarial documents the general tax rate is 1%.

B.7 Business and profesional activities tax

The business and professional activities tax is a local direct tax levied annually on the performance in Spain of business, professional, or artistic activities, regardless of whether or not they are carried out in a particular premises. The tax payable depends on different factors, such as the type of activity carried out and the location and size of the premises where the activity is carried out. As regards limits, it may not exceed 15% of the presumed average profits of the professional/economic activity.

CIT payers and non-resident companies carrying on an activity in Spain through a PE are exempt from this tax if their net turnover for the tax year of the last CIT/NRIT return filed prior to the date of accrual of the local tax (1 January) was less than EUR 1 million.

C. TAXATION OF INDIVIDUALS

C.1 Tax Residence

An individual is considered to be resident for Spanish tax purposes if any one of the following requirements are met:

a) He remains in Spain for more 183 days in one calendar year.
b) His principal place of business, professional or economic interests is located in Spain.

Furthermore, a presumption of residence for tax purposes in Spain arises when the family (spouse not legally separated and dependent children) habitually reside in Spain.

C.2 General regime and tax rates

Residents in Spain are subject to personal income tax on worldwide income in a progressive rate from 19% to 46,5%* (*this is the maximum tax rate applied in the Canary Islands).

Investment income, such as dividends, interest from bank deposits and capital gains obtained by a Spanish tax resident generally are subject to taxation to a progressive rate of 19% on the first 6.000€ of income, 21% on income over 6.000€ and up to 50.000€, and 23% on income exceeding 50.000€.

On the contrary, individuals who are not tax residents in Spain are subject to tax on Spanish source income only. In general terms, the tax rate applicable is a flat rate of 24%. However, if the individual is tax resident of other EU or EEA Member State with wich there is an effective exchange of tax information the tax rate will be 19%.

Interest, dividends and capital gains derived from transfers of assets obtained by non-residents without a permanent establishment shall be subject to 19%.

Special Tax Regime for expatriates

Individuals who are going to acquire residence status in Spain and who comply with certain requirements shall be able to opt for the special tax regime during a six years period.

Under such Special Tax Regime, the individual would be taxed only on the Spanish source income at a flat rate of 24% on the gross income (no deductions or allowance are permitted), up to a maximum amount of 600.000 Euros (the excess will be taxed at a 45%).

In order to apply for this special tax regime it is necessary that certain conditions are met:

The individual must not have been a resident of Spain for tax purposes in the 10 tax periods prior to that of their assignment to Spain.

The assignment to Spain is the result of an employment contract (either a local contract or through a letter of assignment), or the result of acquiring the status of administrator of a company, provided certain requirements are met.

Income may not be obtained by what is would qualify as a permanent establishment in Spain

	Personal Income Tax	Special tax regime
Tax rate	19 % to 46,5 %	24 % up to EUR 600.000
Employment income aerned between the 1st of January adn the arrival date, within the fiscal year of arrival of the employee	Subject to tax	No subject to tax
Employment income earned between the departure date and the 31st of December within the fiscal year of departure of the employee	Subject to tax	No subject to tax
Private income in Spain	Subject to tax	No subject to tax
Private income abroad	Subject to tax	No subject to tax

Salary	Personal Income Tax	Special Tax Regime
28.000	15,67 %	24 %
40.000	19,41 %	24 %
60.000	25,42 %	24 %
80.000	30,34 %	24 %
100.000	33,50 %	24 %
150.000	37,83 %	24 %
600.000	46,50 %	24 %

D. SOCIAL SECURITY

All employers, workers, self-employed workers, etc who work in Spain, must be registered in the Spanish social security system.

In general terms, the Spanish Social Security system comprises two different types of program:

- General social security program, which includes all employees.
- Special social security programs for self-employed workers.

In 2017, the general employer contribution is 29.9% for general contingencies, and the employee contribution is 6.35%. These rates are applied to certain minimum and maximum contribution bases (depending on the worker's occupation category), with the maximum contribution base being EUR 3,751.26.

In general, self-employed persons under 47 years of age may choose the level of contributions they wish to pay within their income bracket. Social security benefits depend upon the social security contributions that are paid. The general rate is 29.80% and it is applied on a monthly social security contribution base of between EUR 919.80,00 and EUR 3.751,20.

Under specific circumstances for persons 47 years of age the contribution base cannot be higher than EUR 1,964.70 per month. For persons 48 years of age and over, the minimum social security contribution base is increased to EUR 992,10 although, in some cases, it may reach up to EUR 2,023.50 per month.

Special rules apply to self-employed persons who have paid social security contributions to other social security regimes for five or more years, before they reach 50 years of age.

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