

TAXATION IN EUROPE

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What did 2007 bring in terms of fiscal reforms in Europe?

IREF, the Institute for Research on Economic and Fiscal Issues, has asked eleven experts from the four corners of Europe to report on the main trends in their countries and neighboring countries. This gave us the 15 reports presented below.

We already knew what the general situation and trends are in the EU. Namely, that the EU-27 is still the region of the world with the highest fiscal burden, that situations differ greatly among EU member states (with new member countries having lower fiscal burden) and that some trends can be found in the evolution of the tax-mix with, for instance, a weak tendency to replace corporate income tax and labour tax with consumption tax. The reports presented here give life to those statistics.

They reveal what were the priorities and constraints of the government in each country?



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They point out to the structural weaknesses of each country's fiscal system and give a critical presentation of the novelty recently introduced. Let me quickly give you a sample of what you will find in the following pages.

Total tax revenue (including social security contributions)
in % of GDP

| | 2004 | 2005 | DIFFERENCE 2005-2004 |
|------------------------|------|------|-------------------------|
| Belgium | 45.0 | 45.5 | 0.5 |
| Bulgaria | 35.3 | 35.9 | 0.6 |
| Czech Republic | 36.8 | 36.3 | -0.5 |
| Denmark | 49.3 | 50.3 | 1.0 |
| Germany | 38.8 | 38.8 | 0.0 |
| Estonia | 31.4 | 30.9 | -0.4 |
| Ireland | 30.5 | 30.8 | 0.2 |
| Greece | 34.3 | 34.4 | 0.1 |
| Spain | 34.5 | 35.6 | 1.1 |
| France | 43.1 | 44 | 0.8 |
| Italy | 40.7 | 40.6 | -0.1 |
| Cyprus | 33.5 | 35.6 | 2.1 |
| Latvia | 28.5 | 29.4 | 0.9 |
| Lithuania | 28.3 | 28.9 | 0.5 |
| Luxembourg | 37.9 | 38.2 | 0.3 |
| Hungary | 38.6 | 38.5 | -0.1 |
| Malta | 34.2 | 35.3 | 1.1 |
| Netherlands | 37.7 | 38.2 | 0.5 |
| Austria | 42.8 | 42 | -0.8 |
| Poland | 32.6 | 34.2 | 1.6 |
| Portugal | 34.2 | 35.3 | 1.1 |
| Romania | 27.3 | 28 | 0.7 |
| Slovenia | 39.6 | 40.5 | 0.8 |
| Slovakia | 29.7 | 29.3 | -0.4 |
| Finland | 43.4 | 43.9 | 0.5 |
| Sweden | 50.5 | 51.3 | 0.7 |
| United-Kingdom | 35.9 | 37.0 | 1.1 |
| Norway (non EU member) | 43.8 | 44.3 | 0.5 |
| EU-27 | | | |
| GDP-weighted average | 39.2 | 39.6 | 0.4 |
| arithmetic average | 36.8 | 37.4 | 0.5 |

Source: Eurostat 2007

According to **Juan José Rubio Guerrero and Julio Pomés Ruiz, Spain** just missed the opportunity to further reduce taxes and boost the economy. They look in details to the various schemes related to the aging problem. Also, in their view, the 2006 reform of income tax penalizes small savers and benefits speculators. Curiously, even long term savings receive no favor: "The maximum limits for contributions to pension plans are to be significantly reduced as from 2007". recent reforms of corporate income tax deserve, according to them, the same judgment: the law does not introduce any substantial change and the changes appear inappropriate to the present situation of the Spanish economy.

From the opposite corner of Europe, **Ruta Vainiene** tells us how **Lithuania** benefits from tax competition: "If it was not for international tax competition, Lithuania would impose progressive personal income tax, higher corporate income tax. There would be no discussions on social security contributions ceiling." Still, the political mood is to increase taxes rather than lower them, even though there are clear signs of a Laffer's curve phenomena taking place: Lithuania has rather high tax rates and low revenues.

In **Slovakia**, the 2006 change of government (from free-market to socialist) has left taxation largely unchanged, but, says **Jiri Schwarz**, the tax burden is nonetheless expected to increase in the coming years. Also, an interesting debate is taking place to decide whether one should aim at the most possible neutral system or keep using deductions as incentives. The situation is

We start with a report from **Jan Schnellenbach** who severely criticizes the proposed reforms of **German** inheritance tax law. More generally, even if the desire to increase tax revenues in order to get out of the public finance crisis was understandable, he points to the "recent symptoms of distributive populism" found in Germany.

In the **Netherlands**, on the other hand, Jan Schnellenbach observes that a lot has been done to reduce the tax burden of corporate tax (introducing, for instance, a "patent box" and a "group interest box").

Pierre Bessard reports on **Switzerland** starting with the story of the canton of Obwalden which, after having its proposal for a regressive income tax rejected by the constitutional court, switched to a 12% flat tax (supported by 91% of the voters) that results in an even lower fiscal burden. He reports also on the battle opposing EU and Swiss authorities over what constitutes State aid.



somehow different in the **Czech Republic**: the new government would like to reduce taxes but the level of public deficits is not making the task easy. Some reforms appear to benefit more the high-income households.

In **Denmark**, explains **Jacob Breastrup**, 2007 was marked by a change in municipal structure. More changes on the tax front are coming in 2009, the mood being rather in favor of tax cuts. The same mood prevails in **Sweden**, where the new center-right government has abolished wealth tax.

Meanwhile, **Norway** is taking the opposite direction: the tax structure has remained basically unchanged since 2004 and the base for the wealth tax has been broadened.

Reporting on tax changes in **France**, **Vesselina Spassova** focuses her analysis on the new law aiming at putting French citizen back to work (“TEPA law”). A set of tax incentives has been included in that law such as making overtime work non-taxable, strengthening the “fiscal shield” or reducing death tax for close relatives. Their complexity could lead, however, to disappointing results. Corporate income tax and wealth tax are largely unchanged. The pending question is whether those tax incentives will generate enough growth to cover State deficits and repay a huge public debt. Chances are that they will not.

Italy’s tax orientations have been fluctuating following changes in political majority. In the late 90s, the center-left, Prodi’s coalition has promoted a new dual-income tax (DIT) and a new regional tax (IRAP) for businesses. Those innovations have then been criticized by the Berlusconi’s team for introducing various undesired effects (such as increasing labor cost, or introducing biases in companies’ financial strategies). Personal income taxation has also changed according to the dominant political color. In 2007, says **Giorgio Brosio**, tax revenues surged (as in 2006), this being probably due to the success of policies designed to fight tax-evasion.

Finally, you will find below reports on the fiscal systems of the two new comers in the European Union: **Romania** and **Bulgaria**. In both cases, as you will see, a wind of rapid change is blowing, but there is still room for improvement. **Romania** got a new tax code in 2003 and, since 2004, has a flat corporate and income tax at 16% (the socialists, if elected in 2008, threaten to move back to progressive taxation). But, according to **Radu Nechita**, one should not be fooled by such low tax rates: the tax burden is still heavy when taking into account the uncertainty, incoherence, instability and even the absurdity of tax administration. The retirement pensions are problematic, but in 2007 the first reforms have been implemented.

With a 10% (truly) flat tax on corporate and personal income, **Bulgaria** is ahead of tax competition in the EU and even in the world. **Peter Ganev** describes the most likely impact of those cuts. On the other hand, indirect taxation and social contributions remain rather high (compared to countries such as Ireland). Indirect taxation (VAT and excises) are kept high due to EU harmonization. Still, the global result for 2007 was a budget surplus. Unfortunately, the government used that surplus to rush into extraordinary expenditures.

You will find all this and much more in the following pages that should give you a better grasp at the state of tax competition in the European Union.



The tax reforms that have come into force in 2007 are insufficient to resolve the structural problems that hinder medium-term growth in Spain.

We say insufficient because a golden opportunity has been missed to really stimulate saving and long-term investment by means of a more generous lowering of tax rates. Instead, the situation has been compensated by an inappropriate restriction (from the macro-economic point of view) of tax incentives for saving for retirement, at a time when almost every reputable institutional opinion is warning of the need to anticipate the overall ageing of the population and the financial burdens caused thereby.

Insufficient also because the lower tax revenues envisaged by the Exchequer \tilde{N} estimated at 2 billion euros for Income Tax and a similar amount for corporate tax \tilde{N} will not produce significant effects on fundamental strategic behaviour in economic terms, while this alleged \tilde{O} saving \tilde{O} for taxpayers will not be enough to compensate for the effects of the \tilde{O} cold progression \tilde{O} produced over the last three years, despite the fallacy broadcast to public opinion in relation to successive reductions of tax rates carried out in the annual budgets for each year.

In this regard, it must be pointed out that, far from lessening fiscal pressure on taxpayers, these reductions of tax rates have in fact contributed to increasing it significantly. Since 2004, the tax burden has increased by two percentage points, rising from 34.24% to 36.19% in 2006, whereas in the previous period of 2001-2003 the tax burden remained steady at around 33.53%.

| | 2001 | 2002 | 2003 | 2004 | 2005 (P) | 2006 (A) |
|--|---------|---------|---------|---------|-------------|-------------|
| Public administration tax revenues in % of GDP | 32.98 | 33.53 | 33.56 | 34.24 | 35.25 | 36.19 |
| GDP used in millions of ! | 680,678 | 729,206 | 783,531 | 840,106 | 905,455 | 976,189 |

In addition to macro-economic considerations, there are several other factors that ought to be included in this critique of the tax reforms implemented by the current socialist Government in Spain, as follows:

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Beyond the well-advertised tax cuts, the truth is that fiscal pressure has been increased significantly in the past years

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1.

The 2006 law on income tax (Law no. 35/2006, dated 28th November) has introduced an inappropriate model of dual imposition, differentiating, according to the corresponding tax system, between:

- “general income”, which includes earnings from work, revenue from real estate assets and income from economic activities, and which is assessed at the general tax rate; and
- “income from savings”, which includes earnings from moveable assets (inter alia dividends and interest on accounts and securities) and capital gains, regardless of the number of years over which they have been generated, which are taxed at 18%.

Before 2007, capital gains earned over more than a year were taxed at 15%, while those generated over less than a year were taxed at the general rate. It should also be pointed out that the 40% reduction for revenues from moveable assets obtained over more than two years (or irregular income) have disappeared, as has the 75% reduction for earnings from life insurance policies of over 5 years duration.

Insofar as the tax rate is concerned, there have been minimal modifications: the maximum marginal rate is reduced by two points (43%), a zero tax bracket is applied, and from these parameters a rate with four brackets is constructed, with intermediate rates of 24%, 28% and 37%. This tax rate structure means that taxpayers who happen to cross the relevant tax threshold will have to pay 24% instead of the present rate of 15%, which may produce “jump errors” for taxpayers situated on the edge of such thresholds with respect to their previous tax position.

Furthermore, the method for calculating minimum personal and family exemptions has been altered, such that, instead of being deducted from the tax base, they have, in practical terms, been converted into deductions from the tax liability. In particular, a technical mechanism has been developed in terms of which the minimum personal exemptions for offspring and similar exemptions will be maintained as reductions of the tax base but by way of a method analogous to allowances, so that each taxpayer may reduce the amount allocated to their family circumstances according to the average tax rate. This represents a solution that radically alters a fiscal policy that is strongly rooted in most European countries and that has been taken on board by the Spanish taxation model over the last few years, the objective of which is to tax the “disposable income” of taxpayers once their personal and familiar needs have been attended to.

From a theoretical point of view, any tax reform ought to treat the promotion of saving as an essential element and basis for the capitalization of the country’s system of production. Savings finance physical capital, complement the training of human resources and increase the economic stability of social forces. Another fundamental factor is the search for fiscal neutrality in the various different uses of savings, with the aim of ensuring that the market determines the ultimate value of a security through

Taxation of personal income

incomes are taxed differently according to their nature

those incomes from savings, which used to be taxed at 15%, are now taxed at a rate of 18%

There has been minimal modifications in income tax rates. The maximum marginal rate is reduced by two points to 43%.

The method for calculating minimum personal and family exemptions has been changed for the worst.

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its financial profitability. The regulation consists of applying a treatment similar to that given to chargeable gains to all financial securities, that is to say, the application of a fixed rate of 18%. This regulation introduces a peculiar form of “dualisation” of tax, with the result that general income (including earnings from work, revenue from real estate assets and economic activities, and capital gains not generated by the sale of patrimonial assets) are taxed at the general rate, whereas earnings from moveable assets and capital gains generated by the sale of patrimonial assets are taxed at 18%.

This structure means that receivers of low-income capital revenue, whose current tax rate is situated at 15%, will now be assessed at 18%, which represents an increase in their tax burden of 20%. Moreover, chargeable gains generated over less than a year, which tend to include a high level of speculation, will also now be taxed at 18% instead of at the marginal tax rate. In sum, this reform penalizes small savers and benefits possible speculators.

Furthermore, the problems of transition of the fiscal regime for capital earnings and the recognition of acquired rights will tend to delay the implementation of the system as a whole. This will generate costs of adjustment to the new system and strategic conduct on the part of savers during an extended period of transition, particularly in the case of those who have accumulated a consolidated exemption for capital gains on real estate property at the present time vis-à-vis the disappearance of the transitory regime covering Income Tax gains. In this regard, it would be as well to anticipate in fiscal terms sales of assets acquired prior to 31st December 2004, in light of the disappearance of the Transitory Regime for Capital Gains covering assets acquired before 1996 which allowed such gains to be consolidated.

In addition, the raising of the tax rate from 15% to 18% means breaking a tendency of decrease with respect to the taxation of savings which was prevailing over the last few years. Spain is sailing against the flow of common practice among nations at an international level, that is, to reduce the tax burden on capital earnings. The result of this is to send out “negative signals” in relation to the fiscal treatment of savings derived from foreign investment in Spain.

The introduction of this new system implies the disappearance of mechanisms designed to avoid double taxation of dividends. This reform will benefit high-income earners (all those taxpayers with the maximum marginal rate) and some of those with a 37% marginal rate, while clearly prejudicing low-income dividends. This effect is partially compensated by the exemption for the first € 1,500, whereas, on the other hand, traditional banking products and short-term financial securities (Treasury bonds, debentures, etc.) become more attractive, because as from 2007 the interest thereon will pay 18% rather than the taxpayer’s marginal tax rate, provided that the latter is greater than the rate of reference.

In particular, the tax treatment given to long-term savings merits criticism. To begin with, the reform in this regard seems to us to represent a radical modification in a method of saving that is very sensitive to variations in tax treatment, which, as it stands, may result in the disappearance of the fiscal benefits associated with qualified pension funds, as we know them today. The maximum limits for contributions to pension plans are to be significantly reduced as from 2007. Before this year, there were

Fiscal neutrality no longer prevails, earnings from work and earnings from moveable assets being taxed differently

In sum, this reform penalizes small savers and benefits possible speculators

Spain is sending a negative signal to foreign investors

... mechanisms designed to avoid double taxation of dividends have disappeared.

the fiscal benefits associated with qualified pension funds are reduced and may disappear

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two independent limits: one for employers' contributions, with an annual limit of € 8,000, and the other for individual contributions, with an annual limit of € 8,000, thus totaling € 16,000. But, if the taxpayer's age was greater than 52 years old, the limit went up by € 1,250 for each year over the age of 52 up to a maximum of € 24,250. Under the new law, however, the contributions by employers and employees are computed jointly together and the limit will be the lesser of two figures: either 30% of earnings from work and economic activities or a fixed sum of €10,000 (€ 12,500 for those over 50 years of age).

Moreover, sums received in the form of capital from pension plans will be charged at the taxpayer's marginal tax rate, without the 40% reduction provided for in the revoked legislation. Nevertheless, the reduction for consolidated rights as of 31/12/2006 is preserved. In our opinion, technical reasons exist for diminishing redemption received in the form of capital as a factor for averaging out earnings and reducing progression at the date of instantaneous redemption, since the amount thereof is assessed at the taxpayer's marginal tax rate in the tax year in which the contingency is produced, whereas these circumstances are not taken into account in the new law. In our view, the possibility of receiving such payments in the form of temporary or financial income ought to be considered, bearing in mind the radical approach adopted in the law. It should not be forgotten that, even though the transitory system attempts to respect acquired rights, the creation over the next few years of "spurious" strategies of contribution to these funds over the next few years, according to the conditions and periods of transition (up to 2011), is bound to occur, contrary to the principle of fiscal neutrality invoked by the reform.

Furthermore, a new product for long-term saving is created, namely the "Individual Plan for Systematic Saving", based on the English model. This provision consists of individual insurance policies designed to generate an income for life over a period of 10 years. Their tax system is based on not deducting contributions to the plan from the taxpayer's personal Income Tax base, but the earnings accumulated from the date of the investment up until the constitution of the life income may be exempt from tax. While this provision may be of some interest to certain taxpayers depending on the period during which the Plan is in operation, from a more general point of view, considering the instrument as a saving mechanism for retirement and from the perspective of life-cycle taxation, it is less interesting, as it renounces the option of reducing tax bases during productive periods in which marginal tax rates tend to be higher vis-à-vis an exemption in non-active periods when our rates tend to be lower.

With respect to the general ageing of the population in Spain and corresponding foreseeable financial problems in the system of pensions, tax incentives have been introduced for so-called "situations and/or insurance policies of dependence" to cover needs of aid associated with assistance for the elderly, as a complement to contributions towards tax deductible Pension Plans and Funds. However, both types of anticipatory instruments have been lumped together within the same limits, which will tend to lead to depletion of the financial options open to both funds and, consequently, reduction of their effectiveness as instruments for encouraging such conduct.

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A new product for long-term saving is created: the "Individual Plan for Systematic Saving" based on the English model. How attractive this product will be remains to be seen.

the law attempts to take into account the general ageing of the population, providing tax incentives for assistance for the elderly

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Another strategic aim of the reform ought to be to help provide access to housing for the various citizen groups that require it, by creating fiscal incentives in order to bring unoccupied properties onto the housing market and contribute to the lowering of market prices for dwellings in terms of both rental and ownership. In relation to this aspect, renting out housing to young folk of between 18 and 35 years of age enjoys a reduction of 100€ of the net benefits generated thereby, which is effectively equivalent to an exemption. In addition, the costs of repair and maintenance works on buildings are deductible without limit, which may lead to the generation of negative net results that may be offset against other earnings. The deduction for acquisition of dwellings is kept with minimal changes, although these amendments heavily penalize those acquiring their first habitual residence, since the increased rates for purchases financed by mortgages or similar credits have been withdrawn. Whereas beforehand 20% to 25% of sums paid out in respect of mortgage repayments and interest could be offset against tax liability, the rate as from 2007 will be 15%.

As regards regulatory provisions affecting income tax on an international level, the following should be highlighted:

- The “system for expatriates”, in other words, the fiscal treatment of residents who work abroad. An exemption of up to 60,100€ per annum is envisaged with respect to emoluments for personal work received for jobs actually carried out abroad.
- The “tax system for impatriates”, in other words, the fiscal treatment of foreign residents who work in Spain. In this case, they are offered the option of either paying income tax here as if they were resident (which means they have to pay the corresponding marginal rate, like Spanish residents, calculated by applying the internal Income Tax rate, up to 43%) or being subject to the non-residents’ tax regime (which allows them to pay tax on income earned in Spain at the rate of 24%).

2.

The Corporate Tax Law, as amended in Royal Legislative Decree no. 4/2004, dated 5th March, regulates corporate tax.

Law no. 16/2007, dated 4th July, on the reform and adaptation of mercantile legislation in accounting matters in order to harmonize it on an international level based on EU Regulations, reflects the changes in the amended law in its Additional Provision 8. As this law deals with deductions for reinvestment of extraordinary profits, it will have to be taken into consideration.

The changes introduced with respect to the regulation of corporation tax, as they stand at the present time, again appear insufficient to us, bearing in mind Spanish companies’ needs in the fields of productivity, competitiveness and relocation.

In the first place, under the heading of amortization it is frequently the case that extra-accounting operations may be required, which opens up the possibility of incor-

another strategic aim of the reform is to facilitate access to housing for specific groups of citizens.

the law modifies the tax system for foreign residents and expatriates

Taxation of corporate income

The changes appear insufficient, bearing in mind companies’ needs in the fields of productivity, competitiveness and relocation

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porating some measures for stimulating investment. For instance, a general increase in the maximum coefficients laid down in amortization tables, on the grounds of the reduced periods of technical obsolescence experienced in environments of great technological change, plus a reduction in amortization tax periods (or even freedom of amortization for given securities linked to innovation), representing a form of tax deferment, might well be worth considering, though they have not been taken into account so far.

With respect to tax rates, the important factor in evaluating the true tax burden of a company is to determine its effective rate, which in Spain have traditionally been substantially lower than nominal rates due to the introduction of significant incentives for certain types of investments and activities. Nevertheless, the generalization of reductions in tax burdens for companies suggests that the general rate should also fall, to be situated at around the current effective average corporate tax rate at an international level, that is to say 25%. Given that this tax represents a cost for companies, in some manner it would allow tax treatment internationally to be put on the same level and reduce the differential in employers' costs that so hinders business competitiveness here in Spain.

For such purposes, boldness is required in cutting the tax burden so as to avoid lengthy periods of depression of the nominal rate, as established in the new law, which provides for a reduction in the general nominal rate over a period of two years in the ratio of 2.5 percentage points (32.5% in 2007), so as to situate us at the end of the process with rates of 30% in 2008. However, given the intense processes of tax reform in the corporate sphere being pursued by our EU partners, the aforementioned rates will by then be out of phase. The reduction should have been instantaneous (or almost so), above all bearing in mind the budgetary surplus we have at our disposal to do so, as the positive effects created thereby on corporate margins undoubtedly generate financial returns for the public Exchequer in the form of greater tax revenue. In this regard, the reduction to 25% of tax rates for small and medium-sized companies (SMEs with turnovers of up to 8 million euros) should have been made general as from 2007. In any case, it should be pointed out that SMEs represent 81.5% of businesses declaring Corporation Tax (a total of 883,000 entities).

Insofar as the third important factor subject to discussion in relation to company taxation is concerned (namely, deductions from tax liability for incentives), although it is true that the general lowering of tax rates should be accompanied by reconsideration of the whole regime of deductions from tax liability, there is a need to be particularly cautious here and not put forward extreme proposals advocating the total disappearance of deductions with a view to achieving a badly thought out position of fiscal neutrality. In particular, it is very important not to send out misleading messages as to the priorities of fiscal policy with respect to tax incentives. In this regard, we consider that it is important to maintain a group of deductions with a view to achieving the following goals:

- Promotion of productive investments that generate employment – we therefore propose the preservation of tax benefits consisting in lowering the tax burden for extraordinary profits reinvested in productive assets and activities,

Although the effective tax rate is substantially lower than the nominal rate, the latter should be lowered to the world current effective average corporate tax rate, that is 25%

the nominal rate should be reduced at a faster rate than required by the law... bearing in mind the budgetary surplus...

regarding deductions from tax liability for incentives... there is a need to be particularly cautious and not put forward extreme proposals

it is important to maintain a group of deductions for specific purpose such as reinvesting extraordinary profits, R&D, training employees

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perhaps with some adjustment so as to avoid reinvestment in more financially-based activities (e.g. investment funds) rather than production. The amendments incorporated in 2007 have gone in this direction.

- To maintain or even extend (international casuistry is very rich!) the reach of application of deductions for costs and investment in R&D, but especially in innovation, the basis for productivity in the long term. In the last two years the deductions provided for R&D have been increased by 64%, rising from 160 million € to 262 million euros in 2006. This policy has therefore turned into an instrument that is becoming consolidated and accepted by Spanish businesses, who would find it difficult to understand if it were withdrawn. The change in the present system of deductions that will disappear around 2012, for allowances of 40% for the National Insurance contributions of staff dedicated to R&D and innovation, represents a penalization of those smaller-sized businesses that cannot afford or do not have the capacity for maintaining their own investigators on their staff.
- To increase deductions for costs of training personnel, which is a fundamental instrument for improving our human resources. Not only from an economic but also a social point of view, it is particularly disturbing that deductions for costs of professional training for staff and for the creation of employment for disabled workers seem likely to disappear.

Other tax incentives should be re-examined according to cost / benefit and compliance with EU regulations on State subsidies. Their possible disappearance during a transitory period, so as to permit readjustment of decisions on investment linked to changes in the regime of tax incentives, should also be considered.

It must also be pointed out that the tax regime for holding companies [sociedades patrimoniales] disappears with Law no. 35/2006. The characteristics of these companies include the fact that for over 90 days of the company's financial year more than half of its assets have consisted of securities or elements of equity not subject to any business activities, while at the same time more than half of the company's share capital is held by 10 or less shareholders or by members of a family group. These companies used to compute their earnings according to income tax regulations and paid tax at a fixed rate of 40%, except for capital gains obtained over more than a year, which were charged at 15%. This tax system was definitive for their shareholders who were natural persons resident in Spain, as whatever dividends they received from the company were not charged to income tax. On the other hand, those shareholders who were juridical persons – except for non-residents without a permanent establishment in Spain – were able to deduct 50% of their corporate tax liability with respect to such dividends.

The disappearance of this tax system means that certain transitory decisions of considerable importance will have to be taken into account and examined. For instance, decisions as to whether to maintain such holding companies in existence or liquidate them will require rigorous prior analysis of other special systems available to the

Some deductions must be maintained (investment in R&D, professional training, reinvested profits)

other tax incentives should be re-examined according to cost-benefit analysis and compliance with EU regulations.

The tax regime for holding companies disappeared with Law no. 35/2006....

decisions as to whether to maintain such holding companies in existence or liquidate them will require rigorous prior analysis..

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company concerned as well as its sources of income and the finance mechanisms it uses, among other factors.

In sum, the scheme of reform of the income tax and corporate tax systems that has begun to be applied in 2007 in Spain may be classified as a minor reform, involving mere adjustments of the current model without any significant changes, but which, in many cases, represent a step backwards in the approximation of our system to comparative tax systems in other countries and with little significance in relation to resolution of the problems currently suffered by the Spanish economy.

3.

In conclusion, we would like to express some views on Law no. 36/2006, dated 29th November, on Measures to Prevent Tax Fraud, which has come into force this year 2007. The importance and the serious consequences that the persistence of tax fraud produces for a nation, particularly in certain sectors and activities, cannot be denied. Tax fraud not only causes a reduction in public revenue, which thus affects the quality and quantity of public services, but it also tends to distort the activities of the various economic players depending on their respective compliance with their fiscal obligations. Nevertheless, as a whole, the new law on measures to prevent tax fraud represents in our view a cause for concern and a step backwards in the perception of an amicable relationship between the tax authorities and the taxpayer.

For reasons of space we shall not set out here all the elements that cause us concern (though they are many and varied) in a law that is interventionist, regulatory and places under systematic suspicion a significant percentage of taxpayers who carry out financial operations of certain sophistication. One point that we might highlight, to start with, is the juridical insecurity produced by regulations that refer, for instance, to linked operations, the remittance of cases to the courts, the treatment of the real estate property sector (which is placed under suspicion in its entirety), or to certain cases of lifting the veil, all full of indeterminate legal concepts. This lack of juridical security arises not only from the interpretation of certain given provisions but also as a result of the dramatic increase in formal obligations and requirements for registration derived from such regulations, together with the complexity of the tax system involved. In consequence, this situation gives rise to a significant increase in what is known as “indirect fiscal pressure” (more formalities and duties of registration, which in turn mean more cost for taxpayers in complying with their fiscal obligations).

But it should also be pointed out that failure to comply with such formalities and obligations of registration is accompanied by the creation of serious new breaches of tax regulations entailing significant penalties. Another factor that must not be forgot

New law to prevent tax fraud and stimulate juridical security: some concerns


the law is interventionist, regulatory and places under systematic suspicion a significant percentage of taxpayers who carry out financial operations of certain sophistication

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ten, either, is the question of the effect such new rules may have on the flow of foreign investment into our country, when the requirements, for example, of liability (which are quite onerous) may make it difficult to find administrators or depositories of assets within Spain or at least render such investments more expensive due to the need for guarantees.

Logically, it will not take long for taxpayers to react, and we shall undoubtedly see a substantial increase in litigation.

The following contributions of interest made by this new law may be highlighted:

- The new VAT system for corporate groups. For these purposes, a corporate group is made up of a dominant entity plus affiliate companies that depend on it to the extent of at least 50%. The new tax system, which is of a voluntary nature, will come into force as from 2008 and will permit the accumulation of the VAT returns for all the group companies jointly together in a single balance, with mutual compensation among them. Accordingly, for example, earnings for one entity may be offset by a compensatory amount to be determined for other members of the group, with only the difference payable to the Treasury. The financial benefits for the corporate group are then clear. Moreover, for VAT purposes transactions between group members may be assessed at cost price and VAT exemptions may be waived in relation to intra-group operations so as to benefit the selling company with the right to deduct the VAT due on a given transaction.
- The new regulation of exemptions from wealth tax of assets and rights subject to economic activities carried out by family-owned groups of companies. In this regard, we may point out the anachronistic situation created by the preservation in Spanish tax law of the Net Wealth Tax while practically all other European countries have opted for its unconditional elimination. 

Other facts to be noted: 1. The new VAT regime is good news for corporate groups and 2. the tax on net wealth is maintained



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