Spain's Ruling Party Gets Budget Backing but Still 25 Votes Shy

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Spain's socialist minority government has signed an agreement with the Podemos party for a budget that would impose a minimum tax on large companies, lower the foreign dividends received deduction, and raise taxes on the wealthy.

Whether the ruling Spanish Socialist Workers Party (PSOE), which holds only 84 of the 350 seats in parliament, can get its proposals passed into law is unclear because even the support of the left-wing Podemos party leaves it 25 votes shy of a parliamentary majority. The center-right Popular Party and the good government Citizens party, which together hold 166 seats, have both ruled out supporting the budget proposal.

The budget agreement between the two parties, which was announced October 11, calls for a minimum 15 percent tax on companies and consolidated groups with at least €20 million of annual revenue. The current statutory rate on corporate profits is 25 percent. The proposed budget also would reduce the current 100 percent dividends received deduction (participation exemption) on income from foreign affiliates by 5 percentage points and impose a 0.2 percent financial transaction tax (FTT) on shares issued by Spanish companies with a market value of at least €1 billion.

Javier Vinuesa, a tax lawyer with Andersen Tax & Legal, said that because the budget agreement says nothing about offsetting prior-year tax losses against current-year income, the government will likely achieve its goal of a 15 percent minimum tax by prohibiting the use of that offset. "No matter how many tax credits or tax losses you may have — [and] Spanish groups have accumulated many tax credits during the [recent financial] crisis — you still have to pay at least 15 percent corporate income tax," he said.

Foreign-source dividends and capital gains have been fully exempt from corporate tax since 1996. Vinuesa said the proposal to limit the participation exemption to 95 percent is the most important measure included in the agreement between the PSOE and Podemos. He said it is a step back from a reform measure implemented in 2015 that strengthened the participation exemption rules by extending them to capital gains on the disposal of Spanish shares under specified conditions. "There are serious doubts of the legality of this measure under EU law," Vinuesa said. "It will pose discriminatory treatment for foreign-source income [compared with] Spanish-source income [both] under Spanish tax treaties . . . prohibiting discrimination and even under the Spanish constitutional rules."

Vinuesa downplayed the impact the proposed FTT would have on the competitiveness of the Spanish stock market. "Other countries like the U.K. have a higher stamp duty and their financial markets are very strong," he said.

Javier Prieto, a tax lawyer with Araoz & Rueda, disagreed. "With this proposal, our [stock] market would become less competitive compared to others," he said. "This measure will probably lead to a flight of investments from Spain, as has already happened in France, because it will be borne, directly or indirectly, by the purchasers."

At least one study indicated that the 0.2 percent FTT imposed by France in 2012 has led to a decline in trading volumes.

The budget agreement includes the digital services tax that the government proposed earlier in the month. « That tax would apply to online advertising services, brokering services, and the sale of user data collected over the internet by companies with worldwide turnover greater than €750 million and Spanish sales over €3 million. "This will [expose] those business to international double taxation," Vinuesa said in an email. "They are now taxed in the U.S. [on their global intangible low-taxed income] and [would be] taxed in Spain [by] an 'indirect' tax of 3 percent of their digital revenues."

One key provision of the U.S. Tax Cuts and Jobs Act (P.L. 115-97) passed in December requires companies to pay tax on GILTI at an effective rate of 10.5 percent (increasing to 13.125 percent after 2025). While foreign taxes on the non-GILTI income of a controlled foreign corporation can be taken in their entirety as foreign tax credits, only 80 percent of foreign taxes paid on GILTI are creditable under the TCJA.

Alejandro Esteller-Moré, a professor of economics at the University of Barcelona, said there were no big tax surprises in the budget agreement because most of the measures had been leaked or discussed publicly by the government. Esteller-Moré said he is interested in learning what impact the 15 percent minimum tax proposal would have because the effective tax rate of the companies to which it would apply is in the 10 percent to 12 percent range.

"It should certainly have an impact on firms' competitiveness, as this is not a harmonized tax within the EU," Esteller-Moré said. "Maybe it creates incentives for relocation, or simply more incentives for profit shifting. A priori, an uncoordinated action like this in a globalized world seems very risky; however, I am not aware of any analysis estimating the expected response of firms."

Prieto said consolidated groups are, on average, already paying tax at an effective rate over 15 percent. "Notwithstanding that, there will be [some] companies that pay tax at a rate under 15 percent that will be affected by this measure," he said.

Personal Income and Wealth Tax

Under the budget agreement, the personal income tax (IRPF) rate is to be increased from 45 percent to 47 percent for incomes over €130,000, and by an additional 2 percentage points for incomes above €300,000. If approved, the budget will add an additional bracket for the tax on dividends and capital gains so that qualifying income over €140,000 will be taxed at a rate of 27 percent, up from 23 percent.

The proposed agreement also calls for an increase in the wealth tax from 2.5 percent to 3.5 percent for individuals with net assets of at least €10 million. Esteller-Moré said the impact of the increase would be modest, in part because noncompliance is relatively high. He said authority over the wealth tax has been granted to Spain's autonomous communities, which means they are not required to implement the increase if it becomes law. Madrid, Spain's biggest city, is an autonomous community and has set its wealth tax rate at 0 percent.

Rounding up the additional 25 votes needed to pass the budget could prove complicated. Esteller-Moré said the PSOE might have to promise additional government spending to the conservative Basque Nationalist Party and funding plus political concessions to the Catalonian nationalist parties, which are still licking their wounc after a Popular Party-led government blocked an independence referendum in October 2017 and took control over the putative breakaway region's government. The leader of the Catalonian government has said that pro-independence parties won't vote for the budget unless the government allows a referendum on independence.

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