

Tax briefing

The new regulation of deferred tax assets in Spain

Royal Decree-Law 14/2013, of 29 November, on urgent measures to conform Spanish law to EU legislation on the supervision and solvency of financial institutions ("Royal Decree-Law 14/2013"), introduces a number of measures to allow certain deferred tax assets ("DTAs") to still be treated as capital for the purpose of calculating the capital adequacy ratio of banks following the entry into force of the new international solvency regulations (CRR and CRD IV) in January 2014.

The new international solvency regulations (CRR and CRD IV), adopted in June 2013, and which came into force in January 2014, provide, among other changes, that banks must deduct DTAs from their capital in order to calculate their solvency ratio. This is justified on grounds of prudence, considering that, in general, there is no guarantee that DTAs will retain their value in the event of the entity facing difficulty.

Royal Decree-Law 14/2013 introduces a number of tax measures with the purpose of allowing certain DTAs to continue to be treated as capital, in line with current regulations in other European Union Member States, so that Spanish credit institutions may operate in a similar competitive environment.

New measures introduced by Royal Decree-Law 14/2013 regarding DTAs

The measures introduced by Royal Decree-Law 14/2013 regarding DTAs are: (i) a new special temporary allocation rule for certain adjustments; and (ii) a measure for the conversion of certain DTAs into directly enforceable credits against the Spanish tax authorities when certain conditions are met.

New special temporary allocation rule

Under the new international solvency regulations, tax credits arising from tax losses must always be deducted from the capital of financial institutions for the purpose of calculating their capital ratios.

Therefore, with effect for tax years beginning as of 1 January 2011, a new special temporary allocation rule has been introduced in order to prevent certain DTAs turning into tax credits for tax losses. To achieve this, a limit has been placed on the recovery of these DTAs for tax purposes.

Specifically, this rule provides that certain provisions for impairment of credit rights and other contributions to social security systems and, where appropriate, early retirement schemes, which have been considered as non-deductible expenses and therefore have generated a deferred tax asset (which will result in a smaller amount of corporate income tax to be paid in future tax periods), will be tax deductible in the year in which appropriate recovery of the adjustments takes place, but subject to a limit, being the positive taxable income of the year in which such recovery is applicable (excluding the amount of the recovery itself and before offsetting the tax losses).

The amounts that could not be recovered in a tax period will be included in the taxable income of the following periods with the same limit.

In addition, Royal Decree-Law 14/2013 contains a provision in order to expressly regulate the application of the new temporary allocation rule in the tax grouping regime.

Conversion of certain DTAs into enforceable credits against the Spanish tax authorities

In order for certain DTAs to continue to be treated as capital for the purposes of calculating the solvency ratio, a new measure has been introduced to ensure its value is retained in the event of the entity facing difficulty.

In this regard, the conversion of certain DTAs into enforceable credits against the Spanish tax authorities will take place when certain conditions are met (this is known as the "monetization" of the DTAs).

Specifically, it is provided that DTAs related to provisions for impairment of certain credit rights, as well as contributions to social security systems and,

where appropriate, early retirement schemes, will become an enforceable credit against the Spanish tax authorities when any of the following circumstances occur:

- The taxpayer records financial losses (in which case the enforceable credit will be limited to the same proportion of total DTAs as the financial losses bear to the sum of capital and reserve).
- The entity is in liquidation or is declared insolvent by the courts.

As a result of this measure, the value of these DTAs is guaranteed, since they can always be recovered, even if the entity is facing difficulty, as in these circumstances a conversion into a direct credit against the Spanish tax authorities will take place.

Conversion of tax credits for pending carry-forward tax losses into enforceable credits against the Spanish tax authorities

Royal Decree-Law 14/2013 also provides that certain tax credits arising from tax losses can become directly enforceable against the Spanish tax authorities. This provision raises important questions which hopefully will soon be clarified.

Specifically, it provides that the tax credits for pending carry-forward tax losses will become enforceable credits against the tax authorities, provided that they arise as a result of the recovery of the above-mentioned DTAs from the first fiscal year beginning in 2014.

As stated, this provision raises questions as it is not clear how it is possible for certain DTAs to turn into tax credits for pending carry-forward tax losses with the existence of the new limit mentioned above.

One possible explanation for this provision is if only DTAs generated before 2011 can result in pending carry-forward tax losses, and that the previously stated limit which prevents the conversion of certain DTAs into tax credits for pending carry-forward tax losses, refers to those DTAs generated after 2011.

Nevertheless, a precise definition should be established in order to determine which DTAs are affected by this provision.

Conversion options

The conversion of the above-mentioned DTAs into a credit enforceable against the Spanish tax authorities will allow the taxpayer to opt for either of the following two alternatives:

- Request payment from the tax authorities.
- Offset these credits against certain other tax debts that the entity generates from the moment of the conversion.

Possibility of exchange into public debt securities

It is established that where the aforementioned conversion does not take place (because the entity does not incur financial losses, liquidation or judicial insolvency), and provided that a specified time elapses¹ without recovery of the above-mentioned DTAs, these DTAs may be exchanged for public debt securities.

Conclusion

The new measures introduced by Royal Decree-Law 14/2013 (which, in principle, may apply to any type of entity, although those directly affected will be financial entities) have been welcomed as they put the Spanish financial sector on equal footing with the rest of the European banking system, thus avoiding being put at a competitive disadvantage and receiving unfair treatment.

Notes

¹ The referred period of time is 18 years after the registration of the DTAs on the accounting records. However, if the DTAs have been registered prior to the entry into force of Royal-Decree Law 14/2013, the aforementioned period will start from 1 December 2013, the date it entered into force.

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