

SPANISH PARTICIPATION EXEMPTION REGIME NOW APPLICABLE TO CAPITAL GAINS ON TRANSFERS OF ENERGY SUBSIDIARIES PRIOR TO READY-TO-BUILD STATUS

The Spanish General Directorate for Taxes ("GDT") amends its prior ruling issued in 2021, establishing that energy entities ("SPVs") prior to ready-to-build ("RtB") status are no longer passive (i.e. not entrepreneurial) entities for tax purposes.

EXECUTIVE SUMMARY

- The Spanish Corporate Income Tax ("CIT") Act provides a **95% exemption** applicable when a Spanish entity realises a gain on the transfer of a stake in another entity, provided that certain requirements are met, including, but not limited to, the subsidiary not being a passive entity ("**Spanish Participation Exemption Regime**").
- Initially, the GDT granted the **Spanish Participation Exemption Regime in the case of disposal of shares in an SPV** that had not begun the construction of the plant (ruling V2931-16).
- However, the GDT issued a binding tax ruling in August 2021 (V2265-21) **denying the application of the Spanish Participation Exemption Regime in a very similar scenario**, where the transfer of shares took place when the SPV was still obtaining permits and licences, that is, prior to achieving RtB status.
- Now, the GDT has issued a new binding ruling (V2200-23) confirming that **the Spanish Participation Exemption Regime is applicable to the disposal of shares in SPVs that have not begun the construction of the solar PV plant**, that is, prior to achieving RtB status.
- This new ruling is in line with the latest doctrine of the GDT on the application of the Spanish Participation Exemption Regime to preparatory activities and should bring legal certainty after the controversial binding ruling V2265-21.

Key issues

- According to the GDT, an **SPV that is still under development prior to RtB status**, that is, an SPV that is: searching for land appropriate for the construction of a solar PV plant; carrying out technical and economic feasibility analyses; negotiating lease or surface right agreements; and identifying and managing all permits and licences necessary for the construction of the plant, among other preparatory activities, **is not a passive entity for CIT purposes**.
- Therefore, capital gains on the transfer of shares in such SPVs are eligible for application of the Spanish Participation Exemption Regime if the remaining requirements are met.
- This new ruling is **in line with a previous one** issued in April 2023, **which granted the 95% exemption to the disposal of shares in an entity** that had obtained the licences needed to carry out an **online gambling activity**, despite not having started such activity.

BACKGROUND

The Spanish Participation Exemption Regime provides an exemption applicable to capital gains made by Spanish tax-resident entities on the disposal of a stake in a subsidiary if (i) the transferor holds a minimum 5% stake in such subsidiary; (ii) such minimum 5% stake has been held for a minimum uninterrupted period of one year by the day on which the disposal takes place; (iii) the subsidiary is a Spanish tax resident or, if not a Spanish tax resident, (a) it is entitled to apply the provisions of a double tax treaty entered into by Spain and the subsidiary's state of tax residence or (b) it is subject to a corporate income tax analogous to the Spanish CIT at a 10% rate or higher; and (iv) **the subsidiary is not considered a passive entity for Spanish CIT purposes.**

In cases **where the Spanish Participation Exemption Regime applies, the capital gain is 95% tax exempt** and the remaining 5% is subject to the general 25% CIT rate, so the capital gain is ultimately taxed at an effective 1.25% rate (as opposed to being subject to the general 25% CIT rate in full).

In practice, **the most controversial requirement of the Spanish Participation Exemption Regime is confirming whether an entity is considered a passive entity** for Spanish CIT purposes, especially since the GDT—the agency responsible for interpreting Spanish tax law—has issued contradictory binding rulings on similar questions raised by taxpayers in the energy sector.

Initially, the GDT issued a binding resolution in June 2016 (V2931-16) confirming that **the Spanish Participation Exemption Regime was applicable to the disposal of shares in an SPV** that had only carried out preparatory activities for the construction of a solar PV plant (such as obtaining licences and permits) but had not yet begun its construction, so RtB status had not yet been achieved.

However, the GDT issued another binding tax ruling in August 2021 (V2265-21) **rejecting the application of the Spanish Participation Exemption Regime in a very similar scenario**, where the transfer of shares took place when the SPV was still obtaining permits and licences, that is, before achieving RtB status.

One year later, on 17 October 2022, the tax authorities of Navarre (a Spanish region empowered to enact its own tax laws) issued a ruling in a similar case to the one above, holding that the SPV was carrying out a business activity and that the participation exemption regime could therefore be applied. However, this ruling only affected entities with tax residence in Navarre.

More recently, in April 2023, the DGT issued a new binding ruling (V0863-23) confirming the application of the Spanish Participation Exemption Regime to a Spanish company that incurred expenses in obtaining the necessary **licences to carry out an online gambling activity**, despite not having started that economic activity and not having employees. It seemed that the GDT had amended its position and now considered preparatory activities to be economic activities for the purposes of the Spanish Participation Exemption Regime. Therefore, this binding ruling raised some positive expectations in the energy sector, which believed that the GDT's next step could be a new ruling applying the same position to the energy sector.

THE NEW BINDING RULING (V2200-23)

In September 2023, a new binding ruling was issued, dated 27 July 2023 (V2200-23). In it, the GDT **confirms that a holding entity is entitled to apply the Spanish Participation Exemption Regime** to the disposal of shares in several SPVs, even where they have not begun the construction of the solar PV plant and have not achieved RtB status.

The taxpayer (the holding entity) indicates that **the disposal of its stake in the SPVs could take place (i) while the SPVs are still obtaining the licences and permits to build and operate their plants or (ii) once such licences have been obtained but before construction has started.**

As additional background, while the holding entity has a board of directors made up of five persons and employs three persons, none of the SPVs have hired any employees, as they depend on the employees provided by their parent entity and third-party suppliers.

According to the GDT, the activities already carried out by the SPVs **(searching for land appropriate for the construction of a solar PV plant; carrying out technical and economic feasibility analyses of the land—including a technical, environmental and feasibility analysis—; negotiating lease or surface right agreements; interconnection with the power grid; conducting an environmental impact project; and identifying and managing all permits and licences necessary for the construction of the plant)** will be deemed an economic activity consisting of the development of a solar PV plant.

CONCLUSION

Based on the above, the GDT considers that SPVs involved in preparatory activities are not passive entities for CIT purposes and, consequently, capital gains realised on the transfer of their shares are eligible for application of the Spanish Participation Exemption Regime if the remaining requirements are met (notably, a minimum 5% stake and minimum one-year uninterrupted holding period).

The above ruling marks a milestone in clarifying a question that had created great uncertainty in the energy sector and was hampering investment in projects in preliminary stages.

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