TAXATION OF CHARITIES IN SPAIN[1].

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I. GENERAL REMARKS.

I.1 The main regime: The Charities and Patronage Tax Act, Ch.P. Tax Act herinafter)[4].

The Spanish legislator has created a special tax regime for non-profit organizations with the aim of protecting activities considered necessary in a modern and pluralist society from a social, religious, ethic economic or political perspective, and all that irrespective of the fact that these activities can be normally performed pursuing the obtention of profits. The CH.P. Tax Act[5] sets as its primary goal the

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[4] Ley 49/2002, de 23 de diciembre, de régimen fiscal especial del sector no lucrativo y de incentivos fiscales al mecenazgo.
[5] Due to the complex Spanish system of distribution ox taxing powers between the State and the Regions (*Comunidades Autónomas)* the so-called "Foral regions" – as opposed to "Common regions"- have also enacted their special tax regimes for non-profit organizations: *Norma Foral 1/2004, de 24 de febrero, de régimen fiscal de las entidades sin fines lucrativos y de los incentivos*

promotion of certain activities performed in the general interest, using for it tax incentives normally referred to business profits that have been reinvested in the very activities performed by the non-profit organization.

Therefore, in Spain tax incentives are not only granted to non-commercial activities, such as political or religious, but also to those that can be performed, and very often are performed, with the aim of obtaining profits –cultural, sport or educational activities; as we will see, it is the legal form of the organization that determines, at first instance, the application of the special tax regime.

As stated before, the special tax regime embedded in the CH.P. Tax Act is just applicable to a closed list of entities, detailed in its article 2 and several additional provisions[6]: foundations, associations formally declared in the public interest, other non-profit organizations with the former legal structure, delegations of non-resident foundations registered in the National Register of Foundations[7], sport federations, the Spanish Olimpic Committee, the Red Cross, the *Organización Nacional de Ciegos Españoles* (ONCE), the *Obra Pía de los Santos Lugares,* the Catholic Church and other Churches and Confessions that have signed agreements with the Spanish State, certain benefical construction entities[8] and Public Universities.

The CH.P.Tax Act creates different incentives referred to the Company Income Tax (*Impuesto sobre Sociedades*), the Tax on Immovable Property Acquisitions and Stamp Duties (*Impuesto sobre Transmisiones Patrimoniales y Actos Jurídicos Documentados*), the Tax on Immovable Property (Impuesto sobre Bienes Inmuebles), and the Tax on the Performance of Economic Activities (*Impuesto sobre Actividades Económicas*)[9].

I. 2. The special regime of partially exempt entities for Company Taxation Purposes.

Those non-profit organizations to which the benefits contained in the CH.P.Tax Act are not applicable – for not having the form previously listed according to article 2 or not complying with further requierements analysed below- are not taxed

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fiscales al mecenazgo, *Norma Foral 3/2004, de 7 de abril*, de *régimen fiscal de las entidades sin fines lucrativos y de los incentivos fiscales al mecenazgo Norma Foral 16/2004, de 12 de julio*, de *régimen fiscal de las entidades sin fines lucrativos y de los incentivos fiscales al mecenazgo* y la *Ley Foral 10/1996, de 2 de julio, reguladora del régimen tributario de las fundaciones y de las actividades de patrocinio*.

[6] See additional Provions 5, 6, 8, and 13 of the CH.P. Tax Act.

[7] Non-resident foundations willing to perform activities in Spain must have a delegation in the Spanish territory and register in the National Register of Foundations, according to article 7 of the *Ley 50/2002, de 26 de diciembre, de Fundaciones* (Spanish Foundations Act, Found. Act hereinafter). Therefore those non-resident foundations performing activities in Spain according to the former provisions might apply the same tax benefitis as Spanish foundations. Nevertheless those foreign organizations performing occasional activities in the Spanish territory without being registered will be taxed just as any other non-resident company according to the *Ley del Impuesto sobre la Renta de los No Residentes* (Spanish Non-Resident Income Tax Act, NRITAct., hereinafter).

[8] Those created according to article 5 of the July 15th 1954 Act.

[9] These taxes will be briefly described when it comes to the particular analysis of the previously mentioned incentives.

according to the ordinary rules, but granted partial exemptions for Company Taxation purposes according to articles 9.3 and 120 to 122 of the *Real Decreto Legislativo 4/2004, de 5 de marzo, por el que se aprueba el Texto Refundido de la Ley del Impuesto sobre Sociedades* (Spanish Company Tax Act, CT Act hereinafter).

This special regime is characterized by a limited number of exemptions in comparison to the far reaching benefits enshrined in the CH.P.Tax Act. According to paragraph 1 of article 121 of the CT Act grants an exemption for items of income arising from activities comprised in the social object of the non-profit entity. Nevertheless, paragraph 2 of the same article makes a determinant statement: income arising from business activities shall not be exempted. In order to resolve this blatant contradiction, paragraph 3 of article 121 of the CT Act defines income arising from business activities as that obtained through a combination of work and capital or just through work or capital if the tax payer assuming the "entrepreneurial risk" manages those producing factors with the intention of producing or distributing goods or services. It goes without saying, how difficult it can be to identify an item of income arising from activities comprised in the social object of the non-profit entity and not being at the same time labelled as originated by business activities. Finally paragraph 3 of article 121 of the CT Act grants an exemption for capital gains from the alienation of whatever goods forming part of the business property used for the performance of the social object of the non-profit entity assumed that the total product of the alienation is reinvested in the acquisition of assets related to the very social object.

But, by far, the main problem of this partial exemption regime derives from article 122 of the CT Act dedicated to the rules governing the taxable base. According to that provision expenses incurred exclusively for the performance of exempt activities should not be deducted. This rule makes non-profit organizations, under the scope of the partial exemption regime, to be taxed on a fictious taxable base different from its real profit. For example, an association dedicated to educational activities that organices a turistical visit and charges a price to the assistants will be taxed for the derived income. Nevertheless those expenses incurred for the organization of a free-of-charge course for children will not be deductible as far as they are incurred for the performance of an exempt activity. The final result is that this association will be taxed on a taxable base totally different to its real profit (and alien to its ability to pay) as far as the taxed income used for the development of its social object will not be deductible. If we consider that these tax payers are taxed at a significantly high tax rate of 25 % the final result is really disappointing.

It must be stated finally, that after some discussion in the practice, it became finally clear that the partial exemption regime is not optional and therefore all non-profit organizations that are out of the scope of the CH.P. Tax Act are to be taxed according to it[10].

[10] According to the administrative ruling of the *Dirección General de Tributos* (Spanish Tax Directorate) (Rul. DGT, hereinafter) of June 25th 2003 (0888-03) the partial exemption regime is not optional as far as tax-exemptions define the scope of tax liabilities in combination with the taxable event and therefore they are not made dependant on the desires of tax payers. In the same line also some Spanish Tribunals: rulings of the *Audiencia Nacional* (Spanish first or second

This absurd tax regime is applied to the majority of the Spanish non-profit sector[11]. Most of these non-profit organizations look for financiation through activities normally allien to their social scope that is subject to tax, but by means of which they pretend to finance their real social object, which is normally loss-making. To put it dramatically: these organizations sell T-Shirts, Magazines and other goods and with the obtained income, they finance free Spanish courses for immigrants or a foster home. Their business profits derived from the sales is subject to tax but, on the other hand, the expenses incurred for social activities are not deductible[12].

II. The Charities and Patronage Tax Act.

As stated before, the CH.P.Tax Act creates different incentives referred to several taxes. In order to properly organize the study of this special tax regime we will split the content of this paragraph in two units: the first referred to the conditions on which the application is made conditional (II.1) and the second focused on the tax benefits upon which the special tax regime is based with a special attention, due to its particular importance, to Company Taxation issues (II.2)

II.1 The conditions for the application of the CH.P.Tax Act Benefits.

As stated before the special tax regime embedded in the CH.P. Tax Act is just applicable to a closed list of entities, detailed in its article 2 and several additional provisions of the law. Nevertheless, the mere fact of being one of the entities mentioned in article 2 is not enough to qualify for the application of the benefits contained in the CH.P. Tax Act. Foundations, asociations formally declared in the public interest, other non-profit organizations with the former legal structure, delegations of non-resident foundations registered in the National Register of Foundations[13], sport federations and the Spanish Olimpic Committee must also fulfill further material and formal requirements to become "CH.P. Tax Act entities"[14]. Those entities that despite of not being listed in article 2 might qualify as "CH.P. Tax Act entities" –due to its direct legal qualification under additional dispositions 5 (Red Cross and ONCE), 6 (*Obra Pía de los Santos Lugares*), 8 (Foundations of religious entities), 9 (the Catholic Church and other Churches and Confessions that have signed agreements with the Spanish State) and 13 (certain

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instance for administrative and tax matters, Rul. AN hereinafter) april 11th 2002 (JT 2002/1054) and october 2nd 2003 (JT 2003/1499).

[11] As we will see this problem also arises in the CH.P.Tax Act regime.

[12] Article 136.3 of the CT Act, exempts non-profit organizations from tax computations and returns –which is an indirect way to grant an exemption- if: 1) Its total income is lower tan 100.000 euros on a year basis and; 2) Income related to non-exempt activities and subject to tax witheld by the payer are lower tan 2000 euros on a year basis, and 3) All non exempt items of income obtained are subject to witholding taxes. This exclusion is certainly limited as far as the conduction of a single business activity implies the obtention of non-exempt income not subject normally to witholding taxes.

[13] See footnote 4.

[14] Those tax payers quealifying for the application of the tax benefits embedded in the CH.P. Tax Act are designated in Spain as "*entidades sin fines lucrativos*". The term "CH.P. Tax Act entities" is probably the most accurate translation of this concept and will be used hereinafter in order to avoid longer expressions.

benefical construction entities) of the CH.P. Tax Act - do not need to fulfill those additional requirements and receive direct access to tax benefits contained in the CH.P. Tax Act.

a) Material requirements for the application of the CH.P. Tax Act Benefits to article 2 listed entities.

Article 3 of the CH.P. Tax Act contains ten material (pre)requisites for an article 2 listed entity to que qualified as CH.P. Tax Act entity. Even if these requirements show a disimilar importance, all of them must be fulfilled at the same time to obtain the preferential tax regime:

1) The pursuit of goals in the public interest. The concept of public interest, or general interest, is not legally defined in the CH.P. Tax Act but the very article 3.1º identifies the goals, in an exemplary list as follows: "*defense of human rights, defense of victims of terrorism or violent acts, social assistance and social inclusion, civic, educative, cultural, scientific, sport, sanitary, labour, institutional enforcement, cooperation for development, , promotion of the volunteering, promotion of social action, defense of the enviroment, promotion an atention for persons in danger exclusion due to phisical, economical or cultural reasons, promotion of constitutional values, promotion of tolerance, development of social economy and the Society of the information, scientific research and technical development*".

At the end of the day, everything in which a, more or less generic, group of persons might have an interest shall be considered "in the public interest". The design of this first requirement meets criticism; it is more tan obvious that "the promotion of medieval local games in a remote Spanish region" should not have the same fiscal protection as "research in pediatrical cancer". On the other hand, this kind of open list enables the protection of totally contradictory goals as far as, for example, both, an "association of smokers for the tolerance" and a "foundation against lung cancer" might be performing activities in the public interest according to the law and meriting therefore a preferential tax regime[15].

2) At least 70% of the income obtained in the fiscal year must be invested in the performance of the goals in the public interest pursued by the entity. The percentage must be reinvested in the period of time included between the first day of the fiscal year in which the income has been obtained and the four years following the last day of that fiscal year.

Further nuances must be made in relation to this requisite: a) Capital gains from the alienation of whatever goods are also included in the income that must be reinvested with the exception of those arising from the alienation of immovable property in which the entity performs its social object assumming that the total product of the alienation is reinvested in the acquisition of goods used for the same purpose. b) The amounts received at its creation, or in a later moment, in the concept of contribution are not included for the calculation of the percentage.

[15] Further criticism to this requirement in: PEDREIRA MENÉNDEZ, José. *El régimen fiscal del sector no lucrativo y del mecenazgo.* Pamplona: Thomson-Civitas, 2003, p. 90-91.

3) They cannot perform economic activities beyond the social purpose of the organization. Nevertheless, article 3.3º of the CH.P. Tax Act allows the obtention of income derived from ancillary business activities if: a) The total ancillary income does not exceed 40% of the total earnings of the entity. For these purposes the income originated by the lease of inmovable property is not considered to be generated by the performance of economic activities; and b) The development of economic activities is not in breach of anti-trust regulations in relation to enterprises performing similar activities.

This is perhaps one of the most illogical rules in the whole regime of the CH.P. Tax Act as far as it excludes from its benefits those entities funding their non-profit activities through economic activities. To put it simple, a non-profit organization that inherited a brewery could loose its CH.P. Tax Act-entity condition even if it invested a 100% of the profit generated by the Brewery in its social activity consisting of managing a free of charge retirement village for the Third Age. In this context the only tax planning solution for many non-profit organizations might be the creation of companies wholly participated which perform economic activities distributing its profits to its parent entity. Even if the abolition of a former requisite, contained in the old *Ley 30/1994 de Fundaciones y de Incentivos Fiscales a la Participación Privada en Actividades de Interés General* – that made it difficult for foundations to have substantial participations in companies unless they could proof that it was convenient for the achievement of its goals- would plead for the validity of this scheme for tax purposes, it should not be discarded that the Spanish Tax Administration might correct them, resorting to General Antiavoidance Rules, specially if the donations are deductible for the subsidiary.

On the other hand, the fact that these ancillary activities should not infringe anti-trust regulations should be considered carefully. Nevertheless in relation to this requisite the Spanish Tribunals have repeateadly ruled that the mere fact of enjoying a preferential tax regime does not mean automatically that non-profit organizations are going to give discounts on the price of the services they render. Therefore the distortion of competition must be proven on a case by case analysis and not considered as a given[16].

4) The founders, partners, governing board members, statutory representatives, members of the governance bodies and the spouses or relatives up to the fourth degree, cannot be the principal beneficiaries of the activities carried out by the entities, nor can they take advantage of the services that entities carry out. This requisite is not applicable to foundations that perform research and development, social assistance and sport activities, or that have the protection of the Spanish Heritage as its main goal. It is also not applicable to Sport Federations and Olimpic Committees.

Even if referred literally to all "CH.P. Tax Act entities" this requisite is obviously designed for foundations and specially to face the tax problems of "family

[16] Rulings of the Tribunal Superior de Justicia (Spanish Supreme Regional Tax Court, Rul. TSJ hereinafter) de Castilla-León (Burgos) of October 2nd 1996, February 20th 1998, this later confirmed by the Ruling of the Tribunal Supremo (Spanish Supreme Court, Rul. TS, hereinafter) of January 30 1999.

foundations". Even if "Family Foundations" had been traditionally rejected by the Spanish private law scholars[17], it seems that the CH.P. Tax Act may be admitting "Mixed Family Foundations" (*fundaciones mixtas familiares*) – those that may particularly benefit founders without having it as its main goal[18]. Furthermore, and according to the above mentioned, "Pure Family Foundations" could become "CH.P. Tax Act entities" in those cases in which the tax benefits are not made conditional on the fullfillment of the requiste (foundations that perform research and development, etc…). The problem, in this last case, would be that according to article 3 of the Spanish Foundations Act, these entities cannot pursue any private purpose like giving benefits to the founder or his family. And hence it comes the blatant contradiction: tax law grants benefits to tax payers that, according to private law, could not even exist.

5) The board members and representatives cannot be paid for being part of the Governing Board or assuming their representation tasks; nevertheless they might be reimbursed for the expenses in which they incur for the performance of their functions. The total amount payed, for this last concept, may not exceed the threshold under which allowances are considered exempted for personal income taxation purposes[19]. This requisite is not applicable for sport entities and associations formally declared in the public interest.

Nevertheless, the board members and representatives can be remunerated for any other professional or labour services provided to the entities according to the rules governing its management[20]. In relation to this, article 3.5 of the CH.P. Tax Act introduced an additional restriction according to which board members and representatives may not participate in the profits of the entity. As frequently stated by Spanish scholars, there is no logic to it; a payment by results does not imply any risk, neither from a general private law perpective nor for strict taxation purposes. This ban is just the result of an old fashioned approach to charities and, again, may discourage a professional management of non-profit organizations[21].

6) In case of dissolution, the remaining assets must be transferred to other "CH.P. Tax Act entities" or private non-profit entities that pursue general interest

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[17] In this line the classic work: DE CASTRO Y BRAVO, Federico. *Sobre la pretendida validez de las fundaciones familiares.* /En/ Anuario de Derecho Civil, julio-septiembre, 1953.

[18] Article 3.4º of the CH.P. Tax Act refers to "…*the principal beneficiaries of the activities carried out by the entities*".

[19] According to article 9 of the del Real Decreto 439/2007, de 30 de marzo, por el que se aprueba el Reglamento del IRPF, (Spanish Royal Decree on Personal Income Tax, RIRPF hereinafter) allowances are considered exempted for personal income taxation purposes in the following cases: a) Travelling expenses. Expenses in means of public transport: those that can be justified (with an invoice). Expenses in private means of transport: 0,19 euros per kilometer. b) Acomodation expenses: those that can be justified (with an invoice) and c) Meals: 53,34 euros or 91,35 euros per day depending on the place (in Spain or abroad) where the expenses are incurred. It is obvious that these limits are rather scarce and it might be a serious obstacle for a professional management of non-profit organizations as has been critized by some Spanish scholars: PEDREIRA MENÉNDEZ, José. *El régimen fiscal…op. cit.* p. 112-113.

[20] According to article 15.4 of the Found. Act these professional or labour remunerations are posible as long as: 1) The founder has not expressly forbidden it 2) These services involve a significant contribution to the foundation; and 3) It has been authorised by the Protectorate.

[21] PEDREIRA MENÉNDEZ, José. *El régimen fiscal…op. cit.* p. 116-117.

purposes. This must be expressly stated either in the founding document of the CH.P. Tax Act entity or in its statutes.

Additionally, and according to article 3.6 of the CH.P. Tax Act, in case of dissolution of a CH.P. Tax Act entity, the provisions regarding the special merger tax regime contained in articles 83 to 96 of the CT Act will be applicable. This means, and it is also stated in article 9 of the CH.P. Tax Act, that a dissolution in these cases will not trigger taxation of unrealized capital gains as far as the transferred assets will keep its value and date of acquisition for company taxation purposes. This provision also helps to clarify that the general exemption for capital gains derived by "CH.P. Tax Act entities" granted by article 6.3 of the CH.P. Tax Act, is not applicable to those capital gains generated by dissolution or liquidation.

7) They must register in the corresponding register.

There is a National Register of Foundations and regional registers for each autonomous region. Foundations must register in the autonomous region where their main activity is pursued, but if it is pursued in more than one region, they should register with the National Register[22].

8) They have to fulfil their accounting obligations.

Even if "CH.P. Tax Act entities" have to comply with general accounting rules contained in the Spanish Commercial Code (articles 25 to 41) in 2011 a special adjustment of general accounting rules for non-profit organizations was enacted in Spain (*Real Decreto 1491/2011, de 24 de octubre, por el que se aprueban las normas de adaptación del Plan General de Contabilidad a las entidades sin fines lucrativos y el modelo de plan de actuación de las entidades sin fines lucrativos*".

9) They have to submit anual accounts to the corresponding authorities.

As regards foundations, article 27.5 of the Found. Act requires an annual report must be submitted to the Protectorate, which then sends it to the Public Register where it is available to the public. Once the Protectorate has examined and verified their formal correctness, it will deposit them in the Register of Foundations.

10) They have to submit an anual financial report with specification of income and expenses so that these can be identified per categories and projects. It must also contain a report of participations in comercial Companies.

b) Formal requirements for the application of the CH.P. Tax Act Benefits to article 2 listed entities.

"CH.P. Tax Act entities" will acces the special tax regime contained in CH.P. Tax Act automatically by a mere formal communication to the Tax Administration. The tax regime is therefore optional and immediatly applicable to instantaneous taxes (Tax

[22] In December 2007, Royal Decree 1611/2007 regulating the Register of Foundations of national competence was adopted. It came into force in October 2008.

on Immovable Property Acquisitions and Stamp Duties) and applicable for periodical taxes whose taxing periods conclude after the formal communication (Company Income Tax, Tax on Immovable Property and the Tax on the Performance of Economic Activities).

Once the option has been communicated, the "CH.P. Tax Act entities" regime is granted for next taxing years –assumed that the above mentioned requisites are still fulfiled- unless the entity expressly resigns at least one month in advance to the start of the new taxing year.

II. 2. CH.P. Tax Act Benefits for income tax: "CH.P. Tax Act entities" Corporate Taxation and tax treatment of gifts and contributions in the person of the donor.

Despite the fact that the CH.P. Tax Act regime is applicable also to certain direct local taxes (Tax on Immovable Property and the Tax on the Performance of Economic Activities) and to one indirect tax (Tax on Immovable Property Acquisitions and Stamp Duties) in this paragraph we will merely focus on State direct taxation as far as it is the main content of the special tax regime. Therefore, and following the provided scheme, we will treat the remaining taxes to which the special regime is applicable under the paragraph (Other Taxes).

II.2.1 "CH.P. Tax Act entities" Corporate Taxation.

a) Exempt income for Corporate Taxation on "CH.P. Tax Act entities". (different from those referred in article 7 of the CH.P. Tax Act.

According to Art. 6 of the CH.P. Tax Act, tax exemption on corporate income tax is granted for:

1.) Increases in capital due to inheritances and gifts given to support the purpose of the entity, including sums received at its creation, or in a later moment, in the concept of contribution and also grants from corporations in the concept of "Business collaboration agreements for projects in the public interest*" (Acuerdos de colaboración empresarial en proyectos de interés general*) and sponsorship agreements.

2) Fees paid by members, collaborators and benefactors if the fees do not imply the acquisition of a right to obtain provisions (services) generated by non exempt business activities.

To put it with an example, a Musem-Foundation that charges a price for entrance exercising an exempt business activity according to article 7 of the CH.P. Tax Act and decides to grant a discount for members, collaborators or benefactors will not, due to that only fact, loose the exemption on the fees received. On the other hand, the exemption would be lost in the case that the Foundation also performs an economic activity as the sale of painting, granting a similar discount for members, collaborators and benefactors.

3) Public subsidies unless they are destinated to finance non-exempt business activities.

4) Income from movable and immovable property such as dividends, interests, royalties or leases.

The tax treatment of income from capital, especially regarding dividends, is a clear incentive not to perform directly business activities by non-profit organizations but to create wholly participated companies that perform those activities. Thereby a more neutral situation might be achieved as far as the participated Companies are taxed according to the normal tax regime of the CTA. Therefore a potential distorsion of competion might be discarded[23].

5) Capital gains, including those generated by dissolution or liquidation[24].

b) Income from business activities (article 7 of the CH.P. Tax Act).

According to Art. 7, the following economic activities are exempted, as long as they are carried out in pursuit of the foundation's purpose: Promoting and managing social welfare activities, including activities auxiliary or complementary to these, Hospitalisation and health care assistance, including activities auxiliary or complementary to them, Scientific research and technological development, Activities of goods of cultural interest according to the regulation of the Historical Patrimony of the State and of the Regions, as well as of museums, libraries, and centres of documentation, Organising musical, choreographic, theatrical, cinematographic or circus performances, Foundation activities related to parks and other protected natural spaces, Education and vocational training, Organising exhibitions, conferences, colloquia, courses and seminars, Publication and sale of books, magazines, leaflets, audio-visual and multimedia material.

This is considered to be a closed list according to its very design in article 7 of the CH.P. Tax Act. Nevertheless and perhaps due to that closed character the CH.P. Tax Act has introduced two important nuances: 1) Economic activities that are merely auxiliary or complementary to tax-exempt economic activities or to activities carried out to fulfil the statutory purpose of the entity will be also tax exempted. Nevertheless Economic activities will not be considered complementary if their net income exceeds 20% of the total income of the foundation. 2) Minor economic activities which generate revenues that do not exceed €20,000 are also tax exempted.

This provision merits some comments. The first referred to its interpretation in relation to similar exemptions granted for VAT purposes. The second concerning its very drafting and purpose.

[23] See however the reflections contained in paragraph II.1.a.3.
[24] For the later capital gains see however paragraph II.1.a.6.

The old *Ley 30/1994 de Fundaciones y de Incentivos Fiscales a la Participación Privada en Actividades de Interés General* – repealed by the CH.P. Tax Act- expressly linked exemptions from business activities for income taxation purposes to the fact that these activities were also exempted for VAT purposes. In that context there was a reciprocal influence in the interpretation of both sets of exemptions that was expressly supported by the law. With the exception of educational activities (article 7.7 of the CH.P. Tax Act) this link disappeared in the CH.P. Tax Act and this fact has been accompained by a progressive deviation of the rules governing exemptions for Corporate Tax and VAT purposes. The fact that the text of both sets of exemptions are similar –but not identical- might generate, and is in fact generating, difficult interpretative issues especially regarding wether or not the rich case law and administrative rulings on VAT are automatically applicable for the interpretation of these CH. P Tax Act exemptions[25].

The closed list of economic activities considered exempted according to article 7 of the CH.P. Tax Act is perhaps due to the precaution of the Spanish legislator in relation to potential distortions of competition. Nevertheless, restricting the economic activities that might be considered exempted might not be the solution for this problem as far as the mere non-profit goals of these entities may always grant a prevalent position[26]. The fact of granting benefits according to the origin of income and not to its application will always generate inequalities, lack of neutrality and further problems. As we will conclude in the next paragraph, a system linked to the deduction of expenses related to social activities could be a much better solution.

c) Taxable base.

The regulation of the taxable base in article 8 c is, by far, the most imperfect aspect of the whole special tax regime for CH.P. Tax Act entities. According to that provision the taxable base is to be determined by the difference of: a) Income derived from non-exempt business activities; b) Expenses. Nevertheless, the following expenses are not deductible: 1) Expenses incurred exclusively for the obtaining of exempt income; 2) Depreciation of assets used exclusively for the performance of exempt activities; and 3) Aplication of profits and particularly those that result from the performance of non-exempt activities[27].

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[25] On this problem, especially referred to the taxation of sport federations: BÁEZ MORENO, Andrés; MARÍN-BARNUEVO FABO, Diego. *La tributación de las Federaciones Deportivas.* /In/ Manual de Gestión de Federaciones Deportivas. Pamplona: Thomson-Aranzadi, 2006, p. 246-247.

[26] PEDREIRA MENÉNDEZ, José. *El régimen fiscal…op. cit.* p. 173.

[27] This requisite has been strictly applied by the Spanish Tax Administration. The most aberrant case is perhaps "resolved" in the Rul. DGT May 21 st 1996. An association of mentally handicapped persons that employs its associates in an activity of assembly and packaging of toys, asks wether or not that activity is to be considered "economic" and which is the tax treatment of the amounts paid to the associates. The Tax Administration rules that it is to be considered a non-exempt business activity and the amounts paid to the associates are results from the performance of non-exempt activities and therefore non-deductible. Top ut it simple again: any Company might deduct labor costs; this is not the case for non-profit organizations in many cases. In the same line: Res. TEAC September 26 th 1997 (JT 1997/1428).

This last rule on the deduction of expenses (profits that result from the performance of non-exempt activities) is perhaps the most worrying retriction of all those introduced by article 8 of the CH.P. Tax Act. The outcome of this provision is that profits that result from the performance of non-exempt activities, even if they are invested in the performance of social activities in the public interest, are not going to be deductible for the determination of the taxable base. As a consequence, exactly as we described for the special regime of partially exempt entities, CH.P. Tax Act can be taxed according to a fictious tax base.

As we have already stated, a proper design of tax benefitis for non-profit organizations should not focus on the origin of the income (exemptions due to the origin) but on the destination or application of that income. Therefore the logic leads to a system in which the income is subject to taxation but expenses incurred either for the obtention of income or for the performance of its general interest purposes are deductible taking into account, additionally, that according to article 3.2º of the CH.P. Tax Act at least 70% of the income obtained in the fiscal year must be invested in the performance of the goals in the public interest pursued by the entity. A different system, as that regulated in the CH.P. Tax Act, turns the Corporate Tax for CH.P. Tax Act entities in a tax on revenues (fictiuos profit) instead of a tax on income (real net profit).

The system currently in force in Spain, may also generate problems for non-profit organizations performing at the same time diferente business activities that might be or not exempted. It must be taken into account that article 7 of the CH. P. Tax Act grants an automatic exemption for certain business activities either generating profits or losses. If we combine this with the fact that the exemption might not be renounced –unless the whole regime is renounced according to article 14 of the CH. P. Tax Act- non-profit organizations performing, at the same time, exempt activities (normally loss-making) and taxed business activities (generating profits) will not be able to offset both results. This outcome does not seem coherent with a well designed tax incentive policy and no doubt might be considered incompatible with the ability-to-pay principle as far as it provokes that non-profit organizations are taxed on a fictious income.

d) Tax rate.

Perhaps with the aim of compensating the harmful effects provoked by the regulation of the taxable base exposed above, article 10 of the CH. P. Tax Act establishes a tax rate of 10% instead of the general tax rate of 30% normally applicable for Corporate taxation purposes.

II.2.2. Tax treatment of gifts and contributions in the person of the donor.

Articles 16 to 27 of the CH. P. Tax Act (Title III of the Law) focus on the tax treatment of Patronage (*Incentivos Fiscales al mecenazgo*); even if the law contains several tax benefits related to patronage of particular events, we will focus on the tax treatment of gifts and contributions in the person of the donor. This tax treatment involves particularly a deduction for income tax purposes in the person of the donor whose details will be analyzed next.

a) Donations that give rise to a deduction.

Not all donations made to a CH. P. Tax Act entity[28] give rise to a deduction for the donor according to article 17 of the CH. P. Tax Act. In accordance with that provision, donations, in order to merit the tax benefit, must comply with certain general requirements. Appart from that, the very provision sets a list of goods that being donated might give rise to the deduction. We will analyze both requisites separately.

In order to be benefited, a donation must be irrevocable and unconditional (*irrevocable, pura y simple*). The most complicated interpretative issues are normally referred to the unconditional character of the donation and especially wether or not a symbolic consideration by the donee will make the donator loosing the benefit. Even if the Spanish Tax Administration has been extremely strict in its consideration of the unconditional character of the donation[29], we think that a purposive interpretation of the provision – it just pretends that "remunerative donations" do not qualify for the deduction- leads to a broader interpretation according to which, for example, the donation of a collection with the condition of being exposed showing the donator's name will not make the donator loosing the deduction.

On the other hand, and according to article 17.2 of the CH. P. Tax Act, if the donation is revoked according to the provisions of the Spanish Civil Code[30], the donator will pay in the fiscal year of the revocation the taxes deducted and the corresponding interests for late payment. The most interesting issue in relation to this provision is that a revocation will never give rise to penalties.

Once these general requisites haven been considered, we should analyze which goods, if donated, give rise to a deduction. They are listed in article 17.1 of the CH. P. Tax Act:

1) Money, goods or rights. The deduction is not made conditional on the fact that the money, goods or rights donated are used for the performance of its public benefit purposes. This makes it possible for a CH. P. Tax Act entity to receive goods from enterprises and celebrities and auction them immediately in a television program obtaining thereby funds with which its public benefit purposes are performed, without affecting the right of the donators to a deduction.

2) Associates affiliation fees if they do not imply the acquisition of a right to obtain present or future provisions (services). The problem of this deductible donation is its difficult practical application as far as the great majority of the associations

[28] According to article 16 of the CH. P. Tax Act also donations made in favour of some Public Entities and Public Universities might give rise to deductions in the person of the donor.
[29] For the Spanish Tax Administration the existence of whatever consideration or remuneration eliminates the *animus donandi* and therefore the right to a deduction. For example the obtention of a free entrance for a classical music concert eliminates the deduction for the donator: Rul. DGT July 4th 1997 (1504-97) and February 27th 1998 (0342-98).
[30] Articles 644 to 652 of the Spanish Civil Code.

offers certain return to its associates and this will make the fee not to qualify for the deduction. The lack of coordination between the deduction for the donator and the exemption of the fees for the CH. P. Tax Act entity must be also criticized. We should remember that according to article 6.1.b) of the CH. P. Tax Act fees paid by members, collaborators and benefactors if the fees do not imply the acquisition of a right to obtain provisions (services) generated by non exempt business activities are tax exemted for Corporate Tax Purposes. It makes no sense that a fee might be taxed exempt for the association and not qualify for a deduction in the person of the associate.

3) The constitution of usufructs on goods, rights or securities. This is a very interesting patronage structure especially for artistical and historical goods as far as it allows the assignment of goods, without loosing property, and the correlative enjoyment of a fiscal benefit. Appart from that it reports an additional economic advantage as far as the owners can also make important savings on conservation expenses (especially regarding insurance premiums).

4) The donation of goods integrated in the Spanish Heritage and of cultural goods of ensured quality in favor of entities dedicated to museum activities or to the development or spreading of the Spanish artistical and/or historial wealth.

With no further indications in article 17.1 of the CH. P. Tax Act it seems evident that the donation of services (not goods) is excluded from the fiscal benefit[31]. Therefore an auditing firm rendering free services to a CH. P. Tax Act entity will not be entitled to a deduction. The way to obtain the benefit in the practice, is donating money to the CH. P. Tax Act entity that will pay it back to the person rendering the services for its payment. The rule should be amended in further reforms as far as, even if there has not been case law in this sense, it is possible the Spanish Tax Administration applies in the future anti-avoidance devices to deny the fiscal benefits claiming that this structure is artificial and only aimed at the obtention of a tax saving.

b) The base for the calculation of the deduction.

Article 18 of the CH. P. Tax Act regulates the determination of the base for the calculation of the deduction, setting different rules in relation to the valuation of goods and rights donated[32]. There is a general rule and several special rules for the donation of certain rights and goods.

The general rule establishes for those cases in which the donor is obliged to do commercial bookkeeping (Companies and invidual entrepreneurs[33]) that the tax base will be the book value of the donated good at the moment of the donation

[31] The regional rules governing deductible donations in the "foral provinces" of the Basque Country admit the donation of services.
[32] It is obvious that donations of Money do not need to be valuated.
[33] As a general rule, individual entrepreneurs keep commercial books for personal income taxation purposes. Nevertheless some are excluded especially those being taxed according to a "forfeit system" (*Estimación objetiva*).

(historical value at layman´s terms)[34]. In those cases in which the donor is not obliged to do commercial bookkeeping (natural persons not being individual entrepreneurs) the rules of the Wealth Tax Act (*Ley 19/1991, de 6 de junio, del Impuesto sobre el Patrimonio*, W.T. Act, hereinafter) will be applicable. Even if if the W.T. Act contains several rules on valuation of different goods and rights, article 24 sets market value as the general rule.

As stated above there are also special rules of a certain importance: 1) For usufructs article 18.1.c) d) and e) of the CH. P. Tax Act regulates different valuation rules depending on the nature of the good given in usufruct: 2% of the *valor catastral*[35] per year of duration of the usufruct for immovable property; annual amount of dividends and interests received for securities. 2) For the valuation of goods integrated in the Spanish Heritage and of cultural goods of ensured quality, the value must be determined by an administrative Commision (Junta de Calificación, Valoración y Exportación[36]). Nevertheless, the application of the fiscal benefit for the donation of this kind of goods will be rather scarce in the Spanish practice as far as the "*in lieu of payment*" with the delivery of goods integrated in the Spanish Heritage is permitted. Therefore it will make no sense to donate one of these goods in order to obtain a deduction of a 20% or 35% of its historical or fair value (depending on the donor) if the same good can be given to the Tax Administration for the payment of taxes and according to the 100% of its value. Therefore it has been stated that conditional donations of this kind of goods should have been admitted exceptionally for the purpose of the patronage deductions[37].

c) Calculation of the deduction (rates).

In relation to the percentage of the above mentioned base of the deduction, the CH. P. Tax Act makes a distinction according to the tax payer acting as a donator:

1) Donations made by resident natural persons.

According to article 19 of the CH. P. Tax Act tax payers of the personal income tax (*Impuesto sobre la Renta de las Personas Físicas)* may deduct from tax due 25% of the base of deduction previously described. Nevertheless this deduction is also subject to the limit prescribed in article 69.1 of the *Ley 35/2006, de 28 de noviembre, del Impuesto sobre la Renta de las Personas Físicas y de modificación parcial de la Leyes de los Impuestos sobre Sociedades, sobre la Renta de No Residentes y sobre el Patrimonio* (Spanish Personal Income Tax Act, PIT Act, hereinafter) according to which the base of this deduction may not exceed the 10%

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[34] The application of fair value is rather exceptional in the Spanish Commercial Accounting Law: see BÁEZ MORENO, Andrés. *El "valor razonable" y la imposición societaria: un apunte sobre la idoneidad fiscal de las normas internacionales de información financiera.* /En/ Nueva Fiscalidad, nº 10, 2006, p. 89-188.

[35] *Valor catastral* is an administrative value of immovable property used originally for local wealth taxation but with a widespread use for valuation in Spanish Tax Law.

[36] The *Junta de Calificación, Valoración y Exportación* is regulated in articles 7 to 9 of the *Real Decreto 111/1986, de 10 de enero, de desarrollo parcial de la Ley 16/1985, de 25 de junio, de Patrimonio Histórico Español*. (Spanish Royal Decree on Spanish Heritage).

[37] FERNÁNDEZ FUENTES, G. *Las aportaciones de personas físicas a entidades no lucrativas.* /In/ Revista de la Facultad de Derecho de la Universidad Complutense, Monográfico, nº 20, p. 159.

of the total tax base of the tax payer. If the limit is exceeded, the excess cannot be carried forward being this the biggest difference to the regulation for Corporate Tax payers. This discrimination between natural persons and Companies does not seem to be justified and it constitutes a severe disincentive for the donation of high-value goods to CH. P. Tax Act entities. The solution found by some well adviced tax payers has been a fragmentation of the donation adjusting the annual percentage of the donation to the described limit. It implies important transaction costs but, on the one hand, it allows a full (deferred) enjoyment of the deduction and, on the other hand, it has been admitted by the Spanish Tax Administration[38].

2) Donations made by resident Companies.

According to article 20 of the CH. P. Tax Act tax payers of the Corporate tax (*Impuesto sobre Sociedades)* may deduct from tax due –after all other deductions and bonifications have been made- 35% of the base of deduction previously described. Being this the last deduction –according to the order set up by the C.T. Act- it might be possible that there is no remaining tax due to which the deduction might be applied. Nevertheless the amounts in excess might be applied in the tax returns of the following taxing periods concluding in the next ten years. As previously stated this is the main difference in respect of resident natural persons. Article 20.2 of the CH. P. Tax Act also contains a provision stating that the base of this deduction may not exceed the 10% of the total tax base of the tax payer. But again the amounts in excess might be applied in the tax returns of the following taxing periods concluding in the next ten years.

3) Donations made by non-resident tax payers.

Article 21 of the CH. P. Tax Act also enables non-resident tax payers to make a deduction in relation to donations made to a CH. P. Tax Act entity. In this case the rates and rules governing the deduction depends on wether the tax payer operates in Spain with a permanent establishment: a) Tax payers operating in Spain without a permanent establishment may deduct the donations made to CH. P. Tax Act entity in the same conditions established in the PIT Act. The deduction can be made in the tax returns filed within a year since the date of the donation. b) Tax payers operating in Spain with a permanent establishment may deduct the donations made to CH. P. Tax Act entity in the same conditions established in the C.T. Act.

d) Capital gains generated for the donators.

According to article 23 of the CH. P. Tax Act capital gains generated as a consequence of a donation to a CH. P. Tax Act entity are considered exempted for income tax purposes of the donator regardless of wether it is a resident natural person, a resident Company or a non-resident tax payer. It must be stated that,

[38] Rul. DGT of September 29th 2009 (V2643-09) admitting the fragmentation of the donation of a light aircraft at a 10% annual rate to a non-profit organization that manages a Museum.

normally, the Spanish income tax system also taxes capital gains generated for the donator as a consequence of transactions performed without consideration.

On the other hand, and as far as they are not tax exempted according to article 23 of the CH. P. Tax Act, losses generated for the donor as a consequence of the donation – due to the fact that the donated good has a lower market value than its acquisition value[39]- can be taken into account and offset with other income or capital gains obtained by the tax payer, according to the different rules governing this clearance in the PIT Act or the C.T. Act.

III. VAT/GST OR TURNOVER TAXES.

The application of VAT to charities has never been an easy task. The fact that this tax is regulated and based upon the generation of "monetized added value" – which is not always generated by charities even if these add an evident "real added value"[40]- gives rise to an important amount of inconsistencies and application problems, increased by a lack of systematic in the Spanish implementation of the Council Directive 2006/112/EC (VAT Directive, hereinafter) and frequently accompanied by an erratic administrative practice and case law[41].

Following the VAT Directive, the Spanish Tax Legislation does not contain a special regime of Charities for VAT purposes. In fact, the specific references to Charities in the Spanish VAT legislation are rather limited[42]. As stated before, this does not mean that the taxation of Charities has not rised complicated issues in the Spanish practice, either in relation to general provisions, or related mainly to this kind of organizations but with an important influence upon them, or in connection with VAT regulations that, without being specifically drafted for charities, are basically targeting the non-profit sector. Nevertheless, and following the instructions and

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[39] For example let us assume that a natural person owns a famous painting damaged by a fire, years after its acquisition. Would the tax payer donate this painting to a CH. P. Tax Act entity obtaining a loss it will not be tax exempt and the tax payer may offset it with other capital gains. The same holds true for Companies but the offset might be made without any limits.

[40] This has been considered by Spanish scholars as the real problem of the application of VAT to Charities: CAZORLA PRIETO, Luis María; BLÁZQUEZ LIDOY, Alejandro. *Cuestiones fiscales candentes en materia de Fundaciones: el Impuesto sobre el Valor Añadido.* /In/ Fundaciones. Problemas actuales y reforma legal. Pamplona: Thomson Reuters-Aranzadi, 2011, p. 48. BLÁZQUEZ LIDOY, Alejandro; BOKOBO MOICHE, Susana. *Las organizaciones no gubernamentales en el Impuesto sobre el Valor Añadido.* /In/ Documento de trabajo del Instituto de Estudios Fiscales, nº 30, 2007, p. 12-13. BLÁZQUEZ LIDOY, Alejandro. *El IVA en las entidades no lucrativas. (Cuestiones teóricas y casos prácticos).* Madrid: Centro de Estudios Financieros, 2002, p. 13-19.

[41] A simple search in the Spanish standard case law database (*Westlaw.es*), introducing the terms "charity" and "value added tax" produces more than 1500 administrative rulings and Court decisions. This gives a clue about the huge amount of legal conflicts that these issues have generated in Spain.

[42] Indeed the two only specific references are contained in article 25 of the CH.P. Tax Act, in relation to the "Business collaboration agreements for projects in the public interest*" (Acuerdos de colaboración empresarial en proyectos de interés general*) and their non consideration as supply of services for VAT purposes and article 20.Three of the VAT Act as for the qualification as a "Social Body or Establishment" (*entidades o establecimientos de carácter social*) which constitutes a (pre)requisite for the application of exemptions in the public interest. Both provisions will be analyzed below.

questionnaire provided for the elaboration of this national report, we will merely focus on the deviations from the rules on the VAT directive.

III.1 Non-profit activities as non-economic activities outside the scope of VAT.

According to article 5.ONE.a) of the Spanish VAT Act, those who carry out just free of charge supplies of goods or services shall not be regarded as taxable persons. This statement and in general the very concept of "free of charge supplies of goods or services" has generated intense discussion in Spain bringing out administrative rulings and case law not always in compliance with the VAT Directive or its interpretation by the Court of Justice of the European Union (CJUE, hereinafter). The polemic has been referred to different issues that will be considered separately in the following paragraphs.

a) What is to be considered "free of charge"? The problem of symbolic considerations.

The Spanish Tax Administration has considered in several rulings that activities or transactions carried out for symbolic consideration are not to be considered taxed supplies of goods or services[43]. This reflection seems to be in line with the case law of the ECJ according to which a lease performed for a symbolic price should not be considered a taxed service[44]. Nevertheless a recent Ruling of the Spanish Supreme Court has stated that a transaction made for a symbolic price should not be considered equal to a free o charge transaction[45].

In a direct relation to the very concept of free of charge transactions the Spanish Administration has recently ruled that, for VAT purposes, symbolic consideration and disproportionately below market prices are to be considered equivalent and both transactions could be considered out of the scope of VAT[46]. This new approach seems to come intro contradiction with the case law of the ECJ according to which: " *It is also settled case-law that the taxable amount for the supply of goods or services is represented by the consideration actually received for them. That consideration is thus the subjective value, that is to say, the value actually received, and not a value estimated according to objective criteria*"[47]. According to Spanish scholars identifying symbolic consideration and disproportinated consideration (in relation to market prices) might be in contradiction with the Directive or at least with its interpretation by the Court[48].

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[43] Rul. DGT of may 31st 2010 (V-1169-10). Further Rulings in: CAZORLA PRIETO, Luis María; BLÁZQUEZ LIDOY, Alejandro. *Cuestiones fiscales candentes…op. cit.* p. 51.
[44] ECJ Ruling September 21st 1988 (C-50/1987).
[45] Rul. STS, January 25th 2010.
[46] Rul. DGT of June 7th 2010 (V-1258-10).
[47] ECJ 29 July 2010, *Astra Zeneca UK Ltd*.
[48] CAZORLA PRIETO, Luis María; BLÁZQUEZ LIDOY, Alejandro. *Cuestiones fiscales candentes…op. cit.* p. 52-53.

b) "Business collaboration agreements for projects in the public interest" and sponsorship agreements.

According to article 25 of the CH.P. Tax Act *"Business collaboration agreements for projects in the public interest"* (*(Acuerdos de colaboración empresarial en proyectos de interés general*) are not considered as supply of services for VAT purposes. According to the same provision these agreements are defined as those in which a CH.P. Tax Act entity, for a consideration applied to the performance of its goals, undertakes the diffusion, by any means, of the participation of the collaborator in its activities. There have been intensive discussions in Spain on the differences between this kind of agreements and sponsorship (taxed in VAT)[49]. Nevertheless and being this too linked to the Spanish local practice we will just merely focus on certain administrative rulings in relation to these agreements that might be in contradiction with the VAT Directive.

According to the Rul, DGT. January 18th 2010 (V0028-10) a *"Business collaboration agreement for projects in the public interest"* in order not to be considered a supply of services for VAT purposes must be performed under the scope of article 25 of the CH.P. Tax Act, and therefore non-CH.P. Tax Act entities performing similar collaboration agreements are subject to VAT (supply of services). This ruling seems to run contrary to the principle of neutrality that has been clearly defined, in the area of non-profit organizations and VAT, in the Ruling of the ECJ 26 May 2005 (*Kingscrest Associates Ltd*): "*As regards, secondly, the principle of fiscal neutrality, it must be remembered that that principle precludes, in particular, treating similar supplies of services, which are thus in competition with each other, differently for VAT purposes*". In words of a Spanish scholar, in a direct reference to this ruling, defending that an activity can be subject or not to VAT depending on the subject who performs the activity is simply not acceptable. A service will be subject to tax if it is done for consideration and tax exempt otherwise[50]. Perhaps it is the very article 25 of the CH.P. Tax Act which is in contradiction and perhaps, and according to domestic law, the Tax Administration did not have a different option. Nevertheless the result keeps on being the same.

The Rul, DGT. May 17th 2010 (V1036-10) dealt with a "business collaboration agreement" in which a foundation not only assumed the diffusion of the participation of the collaborator but also granted the collaborator the use of its auditorium, its multi-purpose room and the installation of cash dispensers in its facilities. The Tax Administration considered that the agreement should be split in two parts: one referred to a *"Business collaboration agreement for projects in the public interest"* and not subject to VAT and the rest considered an ordinary supply of services. Some Spanish scholars have considered that this position might run contrary to the general doctrine of the ECJ on the taxable base of VAT[51]. It must be

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[49] BLÁZQUEZ LIDOY, Alejandro. *Análisis crítico del IVA en las Entidades sin fin de Lucro.* Madrid: Instituto de Estudios Fiscales, 2007, p. 82 *et seq.*

[50] CAZORLA PRIETO, Luis María; BLÁZQUEZ LIDOY, Alejandro. *Cuestiones fiscales candentes…op. cit.* p. 55.

[51] CAZORLA PRIETO, Luis María; BLÁZQUEZ LIDOY, Alejandro. *Cuestiones fiscales candentes…op. cit.* p. 55-56 quote the Ruling of the ECJ 29 July 2010, Astra Zeneca UK Ltd. when it states that " *It is also*

concluded that this violation is not as blatant as the one exposed before, but perhaps the solution of taxing the whole contract as a supply of services and according to the global price fixed would be more in line with the Directive.

III.2 Treatment of mixed activities.

It is quite common that non-profit organizations perform, at the same time, business activities subject to VAT and Non-business activities - outside the scope of VAT. The VAT Directive, not specially designed for "out of the market" activities, has not given an explicit solution for these cases, especially in relation to the deduction of input VAT paid for the acquisition of goods and services used in relation to both, business and non-business activities.

Nevertheless the ECJ has dealt with this problem stating in its Ruling of 13 march 2008 ("*Securenta Göttinger Immobilienanlagen und Vermögensmanagement AG v Finanzamt Göttingen*) that: "*…it should be noted that the provisions of the Sixth Directive do not include rules relating to the methods or criteria which the Member States are required to apply when adopting provisions permitting the apportionment of input VAT paid according to whether the relevant expenditure relates to economic activities or to non-economic activities. As the Commission has noted, the rules set out in Articles 17(5) and 19 of the Sixth Directive relate to input VAT on expenditure connected exclusively with economic activities, and distinguish between economic activities which are taxed and give rise to the right to deduct and those which are exempt and do not give rise to such a right. In those circumstances, and so that taxpayers can make the necessary calculations, it is for the Member States to establish methods and criteria appropriate to that aim and consistent with the principles underlying the common system of VAT. In that regard, the Court has held that, where the Sixth Directive does not contain the guidance necessary for such precise calculations, the Member States are required to exercise that power, having regard to the aims and broad logic of the Directive (see, to that effect, Case C 72/05 Wollny [2006] ECR I 8297, paragraph 28). In particular, and as the Advocate General noted in point 47 of his Opinion, the measures which the Member States are required to adopt in that regard must comply with the principle of fiscal neutrality on which the common system of VAT is based. Accordingly, the Member States must exercise their discretion in such a way as to ensure that deduction is made only for that part of the VAT proportional to the amount relating to transactions giving rise to the right to deduct. They must therefore ensure that the calculation of the proportion of economic activities to non-economic activities objectively reflects the part of the input expenditure actually to be attributed, respectively, to those two types of activity. It is appropriate to add that, when exercising that discretion, the Member States have the right to apply, as necessary, an investment formula or a transaction formula or any other appropriate formula, without being required to restrict themselves to only one of those methods. The answer to the second question must therefore be that the determination of the methods and criteria for apportioning input VAT between economic and non-economic activities within the meaning of the*

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settled case-law that the taxable amount for the supply of goods or services is represented by the consideration actually received for them. That consideration is thus the subjective value, that is to say, the value actually received, and not a value estimated according to objective criteria".

Sixth Directive is in the discretion of the Member States who, when exercising that discretion, must have regard to the aims and broad logic of the Directive and, on that basis, provide for a method of calculation which objectively reflects the part of the input expenditure actually to be attributed, respectively, to those two types of activity".

The main problem, for Spanish VAT purposes, is that article 95.1 of the VAT Act only allows the deduction of VAT in respect of supplies of goods or services connected exclusively with economic activities. Aditionally, paragraph 3 of the same provision allows a proportional deduction in cases of partial use connected with economic activities but just in relation to VAT paid for the acquisition of capital goods. Therefore, according to the VAT Act, the "Securenta case-law" could not be applied in Spain in relation to input VAT paid for supplies of goods different from capital goods and services.

Nevertheless the Spanish Tax Administration had offered in its Rul. DGT of May 25 2007 (V1107-07) a similar solution to the formulated one year later by the ECJ in Securenta[52]. All these Rulings pretend the final outcome to be the result of an interpretation according to Community Law and especially according to the VAT Directive. The problem is that the Spanish domestic provision was –and keeps on being- so clear that the final result cannot be considered an interpretation but actually just an overruling of the VAT Act. And there is a real risk that the Spanish Tribunals, using their habitual formalistic approach to tax law issues and due to their traditional reluctance to European-Law arguments, will apply article 95.1 and 3 strictly and without any consideration to the ECJ case law. As stated by Spanish scholars, in relation to this and other issues (following the case-law of the ECJ), the incompatibility of national legislation with Community provisions can be finally remedied only by means of national provisions of a binding nature which have the same legal force as those which must be amended. Mere administrative practices cannot be regarded as constituting the proper fulfilment of obligations under Community law[53].

III.3 Exemptions.

It is in the specific field of VAT exemptions where discussions have been more passionate in the Spanish literature and case law. Nevertheless we will merely focus on two special issues that, in our opinion, imply serious deviations from the VAT Directive.

a) Compulsory or voluntary exemptions?

[52] This Ruling has been confirmed in latter statements of the DGT. Also by the Res. TEAC of February 9th 2010. Further details on these Rulings in: CAZORLA PRIETO, Luis María; BLÁZQUEZ LIDOY, Alejandro. *Cuestiones fiscales candentes…op. cit.* p. 63-66.

[53] CALDERÓN CARRERO, José Manuel. *Una introducción al Derecho Comunitario como fuente del Derecho Financiero y Tributario: ¿Hacia un ordenamiento financiero "bifronte" o "dual"?* /In/ Foro Sainz de Bujanda: Ley General tributaria y Derecho Comunitario, Documentos de Trabajo del Instituto de Estudios Fiscales, nº 2, 2009, p. 140.

The VAT exemptions contained in articles 20.ONE.8 (social services), 20.ONE.13 (sport activities) and 20.ONE.14 (cultural activities) of the VAT Act, are made conditional, according to article 20.THREE, on the corresponding request and formal administrative recognizition regulated, in detail, in article 6 of the *Real Decreto 1624/1992 por el que se aprueba el Reglamento del Impuesto sobre el Valor Añadido* (Spanish Royal Decree on Value Added Tax, VAT Rul. Hereinafter).

Even if there have been several attempts to reform this condition, at this moment in time, the legal situation keeps on being the same[54]. Despite the fact that, as we have already stated in relation to VAT exemptions and sport federations, "sometimes the best way to comply with the VAT Directive purposes seems to be running contrary to its provisions[55]", it seems evident that this conditional, and therefore voluntary character of the exemptions, is a clear deviation from the Directive. The case law of the ECJ is cristall clear in relation to this[56].

The Spanish Tax Administration has not been consistent on the compulsory or voluntary character of these exemptions, defending at the same time an interpretation according to the Directive - and therefore the irrelevance of the request and formal administrative recognition[57]- and a strict interpretation of article 20.Three of the VAT Act[58]. Nevertheless the Tribunals seem to have given a final –even if still provisional- solution for this problem defending that the exemption could not be made conditional on formal request and recognizition[59]. Even if this solution seems to be in compliance with the Directive the same technical problems previously critized in relation to the treatment of mixed activities should be repeated in relation to this particular issue.

b) Management and administration on an essentially voluntary basis.

According to article 133(b) of the VAT Directive:

Member States may make the granting to bodies other than those governed by public law of each exemption provided for inpoints (b), (g), (h), (i), (l), (m) and (n) of Article 132(1) subject in each individual case to one or more of the following conditions:
[…]

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[54] In 2007 the Government tried to introduce a reform in the VAT Rul. in order to state explicitly that exemptions should be applied even if they were not recognized by the Tax Administration. The Spanish *Consejo de Estado* (Spanish Supreme consultive body) rejected the reform putting forward that it was illegal (run contrary to the provisions contained in article 20.THREE of the VAT Act) and that an optional exemption would better fit within the purpose of those exemptions. In 2008 a new proposal to reform the VAT Act was also rejected by the *Consejo de Estado* repeating the previously described purposive argument.

[55] BÁEZ MORENO, Andrés; MARÍN-BARNUEVO FABO, Diego. *La tributación de las Federaciones Deportivas…op. cit.* p. 256.

[56] ECJ September 10 2002 *Kügler*; ECJ May 25th 2005 *Kingscrest.*

[57] Rul. DGT of April 1st 2008 (V-0649-08). See further Rulings in: CAZORLA PRIETO, Luis María; BLÁZQUEZ LIDOY, Alejandro. *Cuestiones fiscales candentes…op. cit.* p. 75.

[58] Rul. TEAC of June 25 2008 and July 9th 2008.

[59] Rul. AN of April 29 2009, and June 3rd 2009.

(b) those bodies must be managed and administered on an essentially voluntary basis by persons who have no direct or indirect interest, either themselves or through intermediaries, in the results of the activities concerned;

Neverthless the Spanish VAT Act makes the application of the exemptions conditional on the fact that the position of president or representative is not remunerated (article 20.Three.2 of the VAT Act). It is evident that the condition settled up in the Spanish VAT Act seems to be stricter than its corresponding rule in the VAT Directive.

It has been again the Spanish Tax Administration, assuming the interpretation given by the ECJ in its march 21st 2002 Ruling (*Zoological society of London*), who has aimed to resolve this apparent contradiction by interpreting the domestic provision according to the Directive[60]. Even if Spanish scholars have again critized this administrative approach, for the reasons already stated[61], we believe that in this case the contradiction between domestic law and Directive is not as blatant as in former cases and therefore an interpretation according to EU Law seems possible.

IV. OTHER TAXES.

As stated in the General remarks of this report the CH.P. Tax Act regime includes other taxes under its scope. In order to follow the scheme provided in the guidelines and to emphasize its minor importance (in comparison to State income taxation) we decided to treat them together in this last paragraph.

IV. 1 Tax on Immovable Property Acquisitions and Stamp Duties.

According to article 45.I.A)b) of the *Texto refundido del Impuesto sobre Transmisiones Patrimoniales y Actos Jurídicos Documentados, aprobado por el Real Decreto legislativo 1/1993, de 24 de septiembre* (Tax on Immovable Property Acquisitions and Stamp Duties Act) CH.P. Tax Act entities are exempted of this tax.

IV. 2 Local Taxes.

Article 15 of the CH.P. Tax Act grants different tax benefits in relation to local taxes for CH.P. Tax Act entities. These benefits will be analyzed in detail below. At this moment we will just make several reflections referred in general to these tax benefits.

The application of these benefits is made conditional on the exercise of the option, ruled in article 14 of the CH.P. Tax Act, and described previously[62]. It must be also communicated to the corresponding city council.

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[60] Rul. DGT march 22nd 2010 (V 0559-10).
[61] CAZORLA PRIETO, Luis María; BLÁZQUEZ LIDOY, Alejandro. *Cuestiones fiscales candentes…op. cit.* p. 81.
[62] See paragraph II.1.b) of this report.

It must be also indicated that the *Real Decreto Legislativo 2/2004, de 5 de marzo, por el que se aprueba el Texto Refundido de la Ley Reguladora de las Haciendas Locales* (Spanish Local Finance Act, L.F. Act hereinafter) also grants non-profit organizations several tax benefits that do not always require the tax payer to be a CH.P. Tax Act entity[63]. In relation to this second group of tax benefits governed by the L.F. Act it must be stated: 1) According to article 15.4 of the CH.P. Tax Act both sets of benefits (CH.P. Tax Act benefitis and L.F. Act benefits) are compatible. 2) If the L.F. Act tax benefit is not designed in relation to CH.P. Tax Act entities, but generally referred to non-profit organizations, its application is not made conditional on the fulfillment of the requisites settled by the CH.P. Tax Act[64].

a) Impuesto sobre Bienes Inmuebles (Local Wealth Tax, LWT, hereinafter)

According to article 15.1 of the CH.P. Tax Act all immovable properties in relation to which a CH.P. Tax Act entity is owner or, in general, LWT tax payer[65] will be tax exempt with the only exception of those that are used for the performance of non-exempt business activities for Corporate Taxation purposes. Therefore only immovable property used by a CH.P. Tax Act entity to perform non-exempt business activities will be subject to the LWT.

The only problem of a such a broad design of the tax benefit is that it might give rise to tax avoidance structures. For instance, a Company might set up a usufruct right on an immovable property that it is not being used for its business activities in favor of a Company Foundation. According to the L.F. Act, the foundation will be the tax payer but the immovable property will be tax exempted for LWT purposes.

b) Impuesto sobre Actividades Económicas (Tax on the Performance of Economic Activities, TPEA, hereinafter).

According to article 15.2 of the CH.P. Tax Act, CH.P. Tax Act entities are tax exempted for TPEA purposes in relation to those activities listed in article 7 of the CH.P. Tax Act. Therefore these entities will be only tax payers of the TPEA in relation to business activities that are not exempted for Corporate Taxation purposes.

c) Impuesto sobre el Incremento de Valor de Terrenos de Naturaleza Urbana (Tax on the Increase in Value of Urban Land, *TIVUL, hereinafter).*

The TIVUL is a local tax on capital gains generated by transactions performed on urban land and the tax payer might be either the purchaser (donations) or the transferor (transactions for consideration). According to article 15.3 of the CH.P.

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[63] For a detailed consideration of these tax benefits see: PEDREIRA MENÉNDEZ, José. *El régimen fiscal…op. cit.* p. 207-208.

[64] This evident conclusion has been confirmed by the Rul. DGT of February 5th 2003 (0150-03).

[65] In order to understand the tax benefits, it must be taken into account that the taxable event of the LWT is the ownership of rights in relation to immovable property according to the following order: 1) Administrative concessions; 2) Surface rights; 3) Usufructs and 4) Ownership. Following this, for example, if a person owns a usufruct on an immovable property, he will be the tax payer being situated before the legal ownership according to the order of the L.F. Act.

Tax Act, CH.P. Tax Act entities are tax exempted for TIVUL purposes when they are liable to the tax.

Even if it sounds redundant – you might be only tax exempt if you are liable to tax- it is an important reference according to the Spanish practice as far as it is extremely common that the purchaser assumes, contractually, the payment of the TIVUL even not being the tax payer (in transactions for consideration). And the case law has been clear in relation to this issue stating that a CH.P. Tax Act the transfer of an urban land for consideration to a CH.P. Tax Act entitity is not tax exempted as far as the later is not liable to tax according to the L.F. Act[66].

[66] Rul. STSJ de Navarra of October 28, 1998 (JT 1998/1554).