Law on the tax scheme applicable to corporate reorganisation transactions and introducing amendments to the Corporation Tax and Personal Income Tax Laws, among others

1. Introduction

On 15 November 2017, the Official Gazette of the Principality of Andorra published Law 17/2017 of 20 October, on the tax scheme applicable to corporate reorganisation transactions and amending Law 95/2010 of 29 December, on corporate tax; Law 5/2014 of 24 April, on personal income tax; Law 21/2014 of 16 October on the tax scheme regulations; Law 20/2007 of 18 October, on public limited and limited liability companies, and Law 21/2006 of 14 December, on capital gains tax levied on immovable asset transfers (hereinafter, the Law).

The main content of this Law is set out below, and will be analysed in the following sections:

- Introduction to the special tax scheme for corporate reorganisation transactions
- Amendment of Law 95/2010 of 29 December, on corporation tax
- Amendment of Law 5/2014 of 24 April, on personal income tax
- Amendment of Law 21/2006 of 14 December on capital gains tax levied on immovable asset transfers
- Amendment of Law 20/2007 of 18 October on public limited and limited liability companies.

2. Special tax scheme for corporate reorganisation transactions

In recent years, the Andorran tax scheme has undergone a process of development involving the introduction of the following taxes: corporation tax, personal income tax and non-resident income tax, among others.

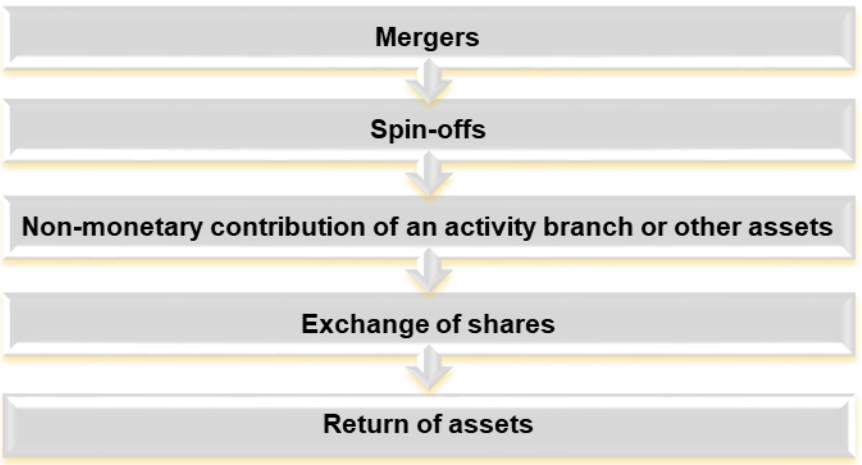
Through this development process implemented on the Andorran tax scheme, capital gains generated in corporation reorganisation transactions were subject to such high levels of taxation that their execution was discouraged.

In view of this situation, and for the purpose of energising the Andorran economy, this Law was passed with the objective of incorporating a special tax scheme for corporate reorganisation transactions.

A summary of the content and provisions of the special scheme is given below:

2.1. Transactions benefiting from the special scheme

The following corporate transactions can benefit from this special scheme:



In qualifying the nature of a transaction to determine the application of the special tax scheme, taxpayers must verify compliance with the definitions and requirements foreseen in the Corporate Reorganisation Law.

2.2. Tax scheme for transferors

Below are the most important implications introduced by the Special tax regime law in relation to the above corporate reorganisation transactions, from the direct taxation standpoint:

- The income derived from operations benefiting from the special scheme is not included in the tax base of the transferor who pays the tax when the transaction is carried out.

  For this purpose, the acquirer must be an individual or a company who is a tax resident of Andorra. In the event the acquirer (individual or company) is not a tax resident of Andorra, the transferred assets must be related to a permanent establishment based in Andorra of the acquirer who is a non-resident, or the transferred assets must consist of shares or equity holdings of an entity with tax residence in Andorra.

- In particular, the income generated in these transactions is deferred and not effectively taxed until the moment when the acquirer subsequently transfers it.

- In the specific case of a non-monetary contribution subject to the special scheme, the shares or equity holdings received by the transferor will be valued at the tax value of the securities in relation to the transferor.

In addition, it should be considered that non-proportional spin-off and asset-return transactions may also benefit from this special scheme. The purpose of these transactions is to facilitate the resolution of situations occurring in Andorran businesses with a special effect on family entities. Consequently, family groups may carry out asset reorganisation transactions and apply the special tax neutrality scheme foreseen in this Law.

2.3. Tax scheme for acquirers

Below are the most relevant consequences of the Special scheme law from the direct taxation standpoint in relation to corporate reorganisation transactions:

- The acquirer will value the assets received as a result of the corporate reorganisation transaction at the same tax value as the transferor before the transaction.
- Likewise, in relation to the acquirer, the acquired assets will also maintain the same purchase date they had for the transferor.

2.4. Tax scheme for shareholders

Corporate reorganisation transactions also have effects in relation to the shareholders of the entities involved, which are described below:

- In merger and spin-off transactions subject to the special scheme of reference, shareholders must not include in their tax base the income arising from the attribution of shares representing the acquiring company.
- Shares or equity holdings received by the shareholders in such transactions are valued at the tax value that the shares or equity holdings of the transferor company had for the shareholders.
- In shares exchange transactions, the derived income will not be included in the tax base, provided shares are received that represent entities with tax residence in the Principality of Andorra.
- Shares or equity holdings received by the shareholders resulting from exchange transactions will be valued at the tax value of the shares or equity holdings issued before the transaction.

  In addition, we should mention that the shares or equity holdings will have the same purchase date of the ones issued in the shares exchange transaction.

2.5. Other considerations

Apart from identifying the tax implications in direct taxation for each of the parties involved in corporate reorganisation transactions, the Law forming the subject-matter of this note includes the following considerations whose scope and content must be taken into account:

- <u>Subrogation of rights and obligations</u>

  In reorganisation transactions carried out by universal succession, the tax rights and obligations are transferred to the acquiring company.

  For this purpose, the acquiring company will undertake to comply with the requirements in order to continue to enjoy the tax benefits or consolidate them.

  In relation to tax losses to carry forward generated by the transferor, it should be said that the acquiring company may apply them, provided the amount exceeds the losses generated by the shareholders of the transferor company in transferring the holdings in its share capital (prior to the corporate reorganisation transaction).

  Notwithstanding the above, when the corporate reorganisation transaction does not imply the universal succession of rights and obligations, the acquiring company will only receive the rights and obligations linked to the assets transferred during the transaction.

- <u>General Indirect Tax (IGI)</u>

  Assets transferred in corporate reorganisation transactions are not subject to IGI.

  Furthermore, the Law considers that this non-subjection of asset transfers has no effects on the input tax deduction scheme.

- <u>Capital gains tax on Immovable Asset Transfers (IP)</u>

This tax is not levied on immovable asset transfers executed in relation to corporate reorganisation transactions subject to the special tax scheme.

In this regard the acquirer will value these assets at the same value they had for the transferor, and their puchase date is also maintained.

- Immovable asset transfer tax (ITP)

  This tax is not levied on immovable asset transfers related to corporate reorganisation transactions to which the special tax scheme is applied.

2.6. Formal obligations

- Application of the special scheme

  The provisions of the special scheme will apply to transactions carried out, excepting if expressly opting for the waiver thereof through the opportune notification to the Tax Administration.

- Purpose of the reorganisation transaction

  The provisions of this tax scheme will not apply to corporate reorganisation transactions in which the main objective is fraud or tax evasion.

  In particular, the law requires transactions of this type to be carried out for valid economic reasons, such as the restructuring and rationalisation of activities. In this respect, it is presumed that the transaction purpose is fraud or tax evasion when it was carried out solely with the aim of obtaining a tax advantage.

- Communication obligation

  Corporate reorganisation transactions must be communicated to the Tax Administration. This communication must be made by the acquirer, whether an individual or a company, prior to formalising the respective public deed.

  This communication obligation will be fulfilled by the transferor when the party receiving the reorganisation transaction is not considered a tax resident of the Principality of Andorra.

  The importance of this communication resides in the fact that the Andorran notary cannot authorise any public document formalising a corporate reorganisation, if the parties required to fail to fulfil said communication obligation.

  Through this communication, the Tax Administration will be informed of the waiver of this special scheme. In this regard, it should be remembered that if the waiver is not expressly formalised, the corporate reorganisation transaction will be subject to the provisions of the special scheme.

  As analysed in section 2.7 below, failure to comply with this communication obligation is a minor tax infringement on which the Law imposes the sanctioning scheme described in section 2.7 below.

- Accounting obligations

  The acquirer is obliged to include the following information in the annual accounts report:

  - The book and tax value of the assets received, as a result of the reorganisation transaction.
  - The dates of the purchase of the assets received, which are maintained.
  - A list of the tax rights and obligations in relation to which the subrogation took place.

- The latest balance sheet of the transferor company.

This information must continue to be included in the report during the periods the acquired assets continue to be included in the assets of the acquiring company.

2.7. Sanctioning scheme

- Breach of the communication obligation

  Failure to provide the respective communication on reorganisation transactions is considered a minor tax infringement.

  The sanction associated with this infringement is a monetary penalty equivalent to 1% of the market value of the transferred assets, without exceeding 50,000 euros.

- Breach of accounting obligations

  According to the Law, failure by the acquiring entity to mention the above information in the annual accounts report is considered a minor tax infringement.

  The sanction associated with this infringement is a monetary penalty equivalent to 0.1% of the market value, without exceeding 3,000 euros.

  This sanction is compatible with that arising from breach of the obligation to communicate corporate reorganisation transactions.

2.8. Effective date

The provisions of this special tax scheme on corporate reorganisations takes effect the day after the publication of the Law in the Official Gazette of the Principality of Andorra.

3. Amendment of the Corporation Tax law

3.1. Entities fully exempt from the tax

The following entities are added to the list of entities fully exempt from Corporation Tax:

- Institut Nacional Andorrà de Finances (*National Finance Institute of Andorra*).
- Agència Andorrana de Protecció de Dades (*Data Protection Agency of Andorra*).
- Agència Andorrana Antidopatge (*Anti-doping Agency of Andorra*).

So, from the date on which the Law takes effect, these entities will be fully exempt from the tax and thus have no obligation to file the respective Tax Return with the Tax and Border Department (Andorran Tax Authorities).

3.2. Limitation in deductions applicable to immovable asset depreciation

Through the new section of Article 10 of the Corporation Tax Law, a limitation is incorporated when considering that expenses recorded as immovable asset depreciation are tax deductible.

In this regard, expenses recorded as immovable asset depreciation will not be deducted from the Corporation tax base, provided the following requirements are met:

- The immovable asset giving rise to the depreciation must be acquired after the date on which the Law takes effect, i.e., the day after its publication in the Official Gazette of the Principality of Andorra.
- These immovable assets must be acquired from related individuals or companies, under the terms set out in Article 16 of the Law (related party transactions).

  Therefore, this limitation does not include depreciation of immovable assets acquired from non-related third parties.

- The amount of the non-deductible depreciation corresponds to that derived from capital gains not included in the following tax bases:

  — Corporation tax

  — Personal income tax

  — Non tax-resident income tax

  — Capital gains tax on immovable asset transfers

  Neither is the depreciation tax deductible in the event that the capital gain generated has been incorporated into the tax base, but is subject to a nominal tax rate of less than 10%.

- Specific case: capital gain subject to a tax rate of less than 10%

The legislation establishes a particularity when determining the deductibility of depreciation expenses in the event that the capital gain on the immovable asset is included in the tax base of the above taxes, but this base must be subject to a nominal tax rate of less than 10%.

In this situation, depreciation expenses will be tax deductible in the following proportion:

$$\frac{\%\text{ of the tax rate to which the capital gain is subject}}{\%\text{ of the general Corporation tax rate (10\%)}}$$

- Specific case: immovable asset depreciation as part of a transaction subject to the special tax scheme

The deductibility of the depreciation expenses forming part of a corporate reorganisation transaction subject to the special tax scheme will depend on the provisions of the special tax scheme.

3.3. Non-deductible expenses: fines and sanctions

The following expenses are not considered tax deductible:

- Criminal and administrative fines and sanctions.
- Surcharges for late filing of tax returns.
- Executive surcharges.

3.4. Non-deductible expenses: donations and atypical donations

Since the Corporation Tax first took effect, expenses related to donations and atypical donations are not considered tax deductible unless they correspond to expenses incurred in public relations with clients or suppliers, or, depending on habits and customs, if they are made in relation to the company staff.

Nonetheless, expenses considered tax deductible must not exceed a limit of 1% of the mean tax base for the current tax year and the previous two tax years.

Through this modification, it is clear that for calculation purposes, the tax base prior to the correction for this concept will be considered when estimating the deductibility limit.

3.5. Non-deductible expenses: expenses with related parties

Expenses incurred in transactions with related companies that comply with the following are not considered tax deductible:

- Transactions carried out directly or indirectly with related companies under the terms

of Article 16 of the Tax Law.

- In the state of source, the income derived from these transactions is not subject to a tax of a similar nature to the Corporation Tax in the Principality of Andorra or is exempt.
- In the state of source, the income derived from these transactions is subject to a nominal tax rate of less than 40% of the general tax rate of the Corporation Tax (i.e., 4%).

Likewise, expenses incurred in related party transactions, in which the income is exempt, not subject or levied at a nominal tax rate of less than 40% of the general tax rate of Andorra due to the *different qualification* of the income in the jurisdictions of origin and residence are not tax deductible.

3.6. Non-deductible expenses: other

Other non-deductible expenses include those arising from actions that are contrary to the law.

3.7. Exemption of income to eliminate double taxation

Andorran companies receiving dividends or income arising from equity holdings transfers (among others) may consider this income exempt, provided the minimum stake and equity holding requirements are met.

With respect to the requirement to be met by controlled companies, the following specific provisions are introduced:

- Controlled companies with no tax residence in the Principality of Andorra must be subject to, and not exempt from, a tax of a similar nature to Corporation Tax. Moreover, they must be subject to a nominal tax rate of at least 40% of the general Corporation tax rate.
- Controlled companies with tax residence in the Principality of Andorra must be subject, and not exempt from, the general tax rate foreseen for Corporation Tax (i.e., 10%).

On the other hand, in the event that the foreseen requirements are not met during all the years when the stake is held, in cases of equity holding transfers, the income generated linearly during the years when the requirements were met will be considered exempt.

3.8. Limitation in offsetting tax losses

A series of limitations is introduced on the offsetting by taxpayers of negative tax bases:

- The majority of the company's share capital must be acquired by a related individual or company after the end of the tax year to which the negative tax base corresponds.
- The above persons must have an equity holding of less than 25% in the share capital at the end of the tax year to which the negative tax base corresponds.
- The company must not have carried out any economic activity for six months prior to the acquisition of the equity holding.

3.9. Deduction to eliminate international double taxation

The Corporation Tax Law specifically foresees that the amount of the deduction to eliminate international double taxation must not exceed the maximum amount of tax payable according to the provisions of the International Double Taxation Agreement.

In this regard, in the event that an Andorran company has paid an international tax similar to Corporation Tax for an amount higher than the one established in the International Double Taxation Agreement, the surplus amount of tax paid cannot be considered when determining the deduction to eliminate international double taxation.

3.10. Payment in advanced

Payment in advanced of Corporation Tax must be filed and settled during the ninth month of the fiscal year.

This means that taxpayers for whom the fiscal year coincides with a calendar year must file the payment in advanced during the month of September (as has been done until now). Nonetheless, in the case of taxpayers whose tax year is different from a calendar year, the payment in advanced must be filed during the ninth month of the current tax year (and not during the month of September).

3.11. Inclusion in the Register of Employers and Professionals

All taxpayers must be included in the Register of Employers and Professionals of the Tax Administration Taxpayer Census.

3.12. Special Objective Assessment Scheme

The special objective assessment scheme is eliminated.

3.13. Tax benefits for creating small businesses

Elimination of the tax benefits established for creating small businesses. These benefits consist of the taxpayer's option of applying a preferential tax rate.

3.14. Effective date of the amendment

The Corporation Tax amendment will apply to tax years starting after 1 January 2017.

4. Amendment of the Personal Income Tax Law

4.1. Non-monetary contributions to companies in which a family relationship exists

The Personal Income Tax Law established that non-monetary contributions made by individuals in favour of companies in which among the shareholders there was a family relationship up to the third degree of kinship were not considered capital gains or losses.

As a result of the introduction to the special corporate reorganisation tax scheme, this section of the Personal Income Tax Law is derogated.

4.2. Deduction to eliminate internal double taxation

Taxpayers who must pay this tax may reduce their tax quota by the amount corresponding to capital gains tax on immovable assets provided that the gain arising from the immovable asset transfer is qualified as earnings from economic activities from the Personal Income Tax standpoint.

4.3. Deduction for elimination of international double taxation

In the event of the formalisation of an Agreement to eliminate international double taxation between Andorra and the State from which the income originates, the deduction for this item must not exceed the respective tax, pursuant to the provisions of the above-referred Agreement.

On the other hand, when estimating the amount of the deduction to eliminate international double taxation, taxes not paid by virtue of exemption, rebate or any other tax incentive cannot be taken into consideration.

4.4. Effective date of the amendment

The amendment of the Personal Income Tax Law will apply to tax years starting after 1 January 2017.

5. Amendment of the Capital Gains Tax Law on immovable asset transfers

5.1. Tax withholding payable by the acquirer when the transferor is not a resident

The Tax Law establishes the obligation of the acquirer of immovable assets to withhold tax on transfers in which the transferor is not a tax resident of Andorra.

Notwithstanding the above, the acquirer is not obliged to withhold tax for this item in the following situations:

- Immovable asset transfers that are exempt.
- Immovable asset transfers carried out after an asset ownership period of ten years.

5.2. Effective date of the amendment

The amendment of the Capital Gains Tax Law on immovable asset transfers comes into effect the day after its publication in the Official Gazette of the Principality of Andorra.

6. Amendment of the Public Limited and Limited Liability Companies Law

6.1. Exchange rate adjustment by monetary compensation in a spin-off transaction

In merger transactions, the Public Limited and Limited Liability Companies Law introduces the possibility of shareholders being able to receive economic compensation to adjust the exchange rate equation.

This monetary compensation must not exceed 10% of the nominal value of the shares or equity holdings attributed as a consequence of the merger transaction.

6.2. Limitation in the merger process

The impossibility of exchanging shares or equity holdings in the company resulting from the merger is established, and so if the shares or equity holdings in the merged companies are included in treasury stock, they must be redeemed or cancelled.

6.3. Attribution of shares or equity holdings to shareholders in spin-offs

The individual consent of the shareholders affected by the attribution of shares or equity holdings is necessary in spin-offs that meet the following conditions:

- Total or partial spin-off transactions.
- Spin-off transactions involving several beneficiary shareholders.
- The shareholders of the company being divided must not receive shares, equity holdings or stakes in all the beneficiary companies.

6.4. Effective date of the amendment

The amendment of the Public Limited and Limited Liability Companies Law takes effect the day after the publication of the Law in the Official Gazette of the Principality of Andorra.

We hope the content of this document will prove useful to you.

We remain at your disposal to provide you with any addition information you may need.

Yours truly,

Crowe Horwath - Alfa Capital
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