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The Evolving Role of the Corporate Income Tax in Spain

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Introduction

The Spanish Corporate Income Tax¹ was born in 1978 on after the fiscal reforms associated with the political transition to Democracy. A tax on company's net income, in addition to the personal income tax, was largely influenced by the experience of other European countries within this area of taxation.

Although in many ways it has performed well, in its 25 years history since the 1978 reform, the CIT has suffered from various technical problems and from a general lack of coordination with Accounting and Mercantile Laws. Furthermore, Economic and Monetary Union membership, along with the growing internationalization of the Spanish economy, has presented new challenges and responsibilities to tax policy makers. In this context, it is not surprising that during this period corporate taxation in Spain has been subjected to continuous evolution, as

reflected in numerous reforms. The main amendments to the CIT were introduced in 1995 with the approval of the new CIT Law. Thereafter, reform has carried on at a slower pace, with partial modifications registered in Budget Laws and in the reforms relating to the Personal Income Tax.

The aim of this chapter is to analyse the structure and performance of the Corporate Income Tax in Spain over the last 25 years. We will study the reasons, principles and objectives of the reforms undertaken and will examine the context of these amendments through the evolution of the basic components of the tax. . Besides, we will study the performance of the CIT from a revenue viewpoint and we will describe the principal results of the empirical studies that analyse the neutrality and competitiveness of the Spanish CIT. Finally, we will discuss some aspects of the reform which are still pending.

The 1978 Fiscal Reform: Origin of the Current Corporate Income

One of the main characteristics of the 1978 Fiscal Reform was the personalization of taxation on income with the establishment of two taxes: Personal Income Tax and CIT.

As in other countries, the CIT has always been a controversial tax in Spain, so much so that it has been discussed at several times over the past whether it should be within the Tax System or not². However, the 1978 Fiscal Reform introduced the CIT in addition to the Personal Income Tax. The main reasons to explain this decision are:

- a) CIT is a control tool on the individuals' income inside a company. It helps improve compliance with other taxes , especially Personal Income Tax.
- b) It taxes the undistributed profit of the companies, avoiding the postponement of taxation until the moment of realization of capital gains.

- c) It is a withholding tax on the non-resident shareholders incomes. This is an important reason due to the difficulty of controlling these shareholders and their higher possibilities of tax avoidance, plus the fact that eliminating the CIT in Spain would not reduce the tax burden of non-residents subject to universal taxation with foreign tax credits.
- d) Corporate Tax is an economic policy tool, which can be used to control company savings and quality and composition of investments, and therefore to implement macroeconomic stabilization policies.
- e) There was already a tax on corporate income in Spain³ and in the Western economies that were trade partners with Spain. It was not a primary source of revenue but it was not insignificant either⁴.

Following the experience of other Western countries and Spain's own experience, the reformers of 1978 opted for a tax on company's net income. Other options were rejected like a tax on the pure profit or a cash flow tax⁵. Company's net income is defined as:

Net Income = Ordinary incomes + Capital Gains and Losses – Ordinary Purchases – Labour costs – Interests of loans – Amortization – Negative taxable income of previous years.

Regarding the coordination between Personal Income Tax and CIT, a partial integration system was chosen. This system tries to correct for economic double taxation through fiscal credits at the shareholder level.

The Principles Behind the Reforms

As we pointed out above, the tax born in 1978 was over the years subject to multiple reforms. But none of them, not even the integral reform of the tax in 1995, involved a radical transformation of the basic tax adopted in 1978. We might think that there

have been a series of shared principles in all these reforms, though in each of them, some principles have been promoted more than others. These principles are:

- Neutrality.
- Competitiveness.
- International Tax Coordination.
- Transparency of the tax law.
- Coordination with financial accounting rules.
- Coordination with the Personal Income Tax.

In a context of open economies, the reform of corporate taxation should put more emphasis on the first three principles mentioned above. In the case of Spain, the process of increasing openness of its economy throughout past years, shows that the principle of competitiveness should have been the main base of the reform of the CIT. Even the other two relevant principles in a context of economic globalization: neutrality and international coordination have found their justification in terms of competitiveness.

Below, we analyze the six mentioned principles and examine the type of reform measures that are justified on the basis of fulfilling those objectives.

Competitiveness

Competitiveness can be defined as the capacity of the companies to keep and expand their participation in the domestic and foreign markets in a continuous way. Its achievement guarantees sustained growth in production and employment.

There are multiple determining factors of enterprise competitiveness. In the first place, it is very important to create a stable macroeconomic framework that guarantees the control of the public sector deficit, price stability and moderate interest rates. But besides this, it is necessary to apply specific policies to foster

competitiveness. Regarding the CIT, some authors argue that its biggest contribution to enterprise competitiveness is to increase its neutrality, so that the governing criterion for investment decisions is productivity and not taxation. However, to the extent that all sorts of market failures exist, the CIT can be used as a tool for promotion and enhancement of overall competitiveness in the economy through actions (some more attractive than others) such as:

- Incentives to R&D activities.
- Incentives to employee training.
- Promotion of the internationalization of Spanish companies.
- Stimulus to exporting activities.
- To facilitate company restructuring and alliances between companies.
- Measures to support small and medium-sized companies, correcting for their financial restrictions.

In addition, the tax bill for the CIT, being a cost component of the company, can be a factor of determining competitiveness. In this sense it is important to analyse the configuration of some basic elements of CIT (nominal tax rate, calculation of taxable income, incentives...) and the effective rate of taxation that they represent, and then compare these effective rates with those of other (country) competitors (see the principle of international tax coordination and section 3.2).

International Tax Coordinaton

The 1978 Law was designed for a closed economy. On the other hand, throughout the years a process of internationalization of the Spanish economy has taken place. This process has been accelerated by the integration of Spain into the European Union in 1986 and the establishment of the Internal (Common European) Market in 1993.

The principle of free movement of capital associated with the Internal Market allows for capital to move freely among the countries of the European Union, so that its allocation is in response to the criteria of economic efficiency, maximizing production and welfare. But, if there are tax distortions that induce capital to be located in response to tax factors rather than efficiency criteria, the freedom of capital movement will not produce the expected benefits in terms of maximization of production and welfare in the Union. In this context, the harmonization of capital taxation is seen as an instrument to prevent taxes from becoming an element of distortion, so that the advantages associated with the Internal Market should be realized.

However, the analysis of the harmonization rules for company taxation shows a low level of development, except for very concrete aspects related to the cross-border cooperation of companies⁶. In its place, a process of tax competition has been developed. In this context, international tax coordination requires to take into consideration the reform trends in the surrounding countries so that no country is placed in a bad position in the competitive race. . Besides, we should consider the proposals of several recent reports that have analysed the diversity of company taxation among EU countries and its effects⁷.

The evolution of the CIT in the EU in recent years shows the development of three general simultaneous trends. The first one has consisted of the extension of the taxable income through a decrease of the incentives to investment, particularly those that have a general and permanent nature. The second one has been the reduction of nominal tax rates that has been combined with a reduction of their dispersion among countries. Finally, the third observed trend has been the maintenance or creation of new specific incentives with a dual goal: to help regional politics, in the sense of

achieving a balanced development of the different areas, and to promote certain activities considered to be of high economic profitability.

It seems that the net effect of these trends is a progressive reduction of the effective taxation of the European average company and also a decrease in the dispersion of effective company taxation among countries (see section 5.2).

As for the reports on company taxation, the proposal with the most significant impact on European Community institutions was the call for the necessary actions to be taken so that companies can take advantage of the Internal Market, eliminating tax obstacles that obstruct the relations among countries. (From this perspective, some measures, such as promoting outbound investments or helping international company reorganizations might be justified.

In addition, it would be necessary to correct two problems of a fiscal nature caused by the process of internationalization in the presence of tax differences between countries. One of them is international double taxation. It is necessary to apply methods for the correction of both juridical and economic double taxation in the international context. The second problem is international tax avoidance, which justifies measures against the thin-capitalization of companies, as well as measures against the use of tax heavens and transfer prices as mechanisms of tax avoidance.

Neutrality

Neutrality is a basic tax principle that has been a mainstay of fiscal reforms, in general, and corporate taxation reform in particular. A neutral tax is one that does not modify the behaviour of economic agents. In a corporate environment, in general, fiscal considerations should not affect decision-making on the sources of finance, the grade and composition of the investment, location, inputs combinations, the legal status, nor the size of the firm.

a) Financial Neutrality.

This type of neutrality demands the total removal of double taxation of dividends so as not to favour debt financing against issue of new shares. Furthermore, it requires avoiding the application of lower tax rates to retained earnings (for whatever reason, including the goal of encouraging self-financing.)

b) Investment Neutrality.

Investment neutrality is achieved when the effective tax rates applicable to different investment projects are equal whatever the integrant assets. For investment neutrality to hold the definition of taxable income should closely approximate true economic profit. The main policy measures to be applied here include the following:

- Tax amortization has to be defined in close agreement with the real economic depreciation.
- Capital gains need to be taxed like normal profits without exemption or deferral.
- To allow the full offset of losses.
- The adjustment for inflation in taxable income components, like amortization, capital gains, stock valuation, taxable and deductible interest and offsetting losses.
- Removing the incentives to investment which favour some assets against others.
- Locational Neutrality.

Location choice should be determined by economic efficiency factors instead of fiscal ones. With this aim, at the national level, incentives to invest in certain regions should be prevented. At the international level, methods for correcting international double taxation should be applied. These methods should bring closer together the

fiscal treatment in the following three investment activities: domestic, outbound and inbound investment. So that, capital export and capital import neutrality could be actively pursued.

c) Neutrality in input combination.

Despite the fact that the economic incidence of the CIT is not known with any certainty, if we consider that the burden of the tax is born by shareholders, then the CIT would discriminate against the use of capital vis-à-vis other inputs. To prevent this, it has been proposed to tax only the true economic profit, which can be attributed to all inputs as a whole. On the other hand, tax incentives for investments should be avoided because they can favour the use of *capital – intensive* techniques against labour and other inputs.

d) Neutrality in the choice of legal status.

Every company should receive the same fiscal treatment, regardless of its legal form. Thus, special tax regimes to certain entities, like general partnership and cooperatives, should be avoided. In addition, the fiscal treatment for non-corporate and incorporated enterprises should be quite similar.

e) Neutrality in regard to firm size.

Firm size should be based on the optimum size to produce and provide goods and services from an economic point of view. It should not be affected by fiscal reasons.

In spite of being an important principle of fiscal reform, just about every country has introduced exceptions to the principle of Neutrality. Special treatments and exceptions are justified when they try to rectify different forms of market failure. From the point of view of resource allocation, the existence of positive externalities could justify granting incentives to investment in certain activities, for example, R&D or employee training expenses. Others have justified especial treatment in cases of

certain geographical areas with low investment levels and that are economically depressed, or the especial treatment given to certain clusters of enterprises, such as small and medium sized companies, which may be disadvantaged because of the lack of access to credit markets and other forms of financial restrictions. An exception toward neutrality may also be granted for stabilization policy purposes, whereby fiscal incentives are used on a temporary basis for anti- cyclical purposes.

Anyway, deviations from the neutrality principle through granting different types of tax incentives should include the following terms:

- To follow rigorous and pre-established criteria.
- To choose the incentive techniques to get the objective. Some of these techniques include: accelerated depreciation, exemption or deferral of capital gains, deductions from taxable income or from tax due, or decreases in the nominal tax rate.
- To assess the collection/administration costs of the incentive in relation to the rate of achievement of the objective.
- To avoid too much complexity in the tax law.

International Neutrality

In the context of economic globalization the meaning of the location neutrality principle turns out to be particularly relevant. This is the concept of neutrality in the international allocation of capital. This means that taxes on capital do not modify the location of the new investments across countries, but rather that the location decision is the same as the one that would take place without taxes. There are two different ways of understanding international neutrality: capital import neutrality (CIN) and capital export neutrality (CEN). The first, CIN, occurs when the importing country taxes domestic and foreign suppliers of capital in the same way. It will be attained

with exemption of the outbound income to exporting country⁸ provided that the importing country⁹ does not practice tax discrimination between domestic and foreign investors. The second, CEN, prevails when the tax system of the exporting country provides no incentive to invest at home rather than abroad to resident investors, or vice versa. It is achieved when investors are taxed on accrued worldwide income without deferral and receive full credit against the domestic tax liability for all taxes paid abroad¹⁰.

Both types of neutrality, CIN and CEN could be achieved simultaneously if effective tax rates were identical across countries. The difficulty of achieving such an advanced level of fiscal harmonization requires giving priority to one of the two concepts. In this context, the CIT reform, in accordance with the international tax neutrality principle, demands correcting for international double taxation, which may better contribute to the achievement of the concept of neutrality that is most desired. Providing support for CIN would imply the use of exemption methods; and providing support for CEN would require the use of credit methods.

Transparency of the Tax Law

The CIT is a complex tax due to the complexity of the object of taxation, a company's business reality, and also because of the legislators' desire (for equity reasons among others) to adapting the tax laws to the true individual taxpaying capacity of the firm. This natural complexity is often reinforced by a feature which regularly has accompanied this tax: the dispersion of the tax law in different legal texts. There are several reasons for this dispersion, including the proliferation of partial reforms and the use of this tax as an economic policy tool via the granting of tax incentives.

All things considered, the 1978 Law was object of several changes which were dispersed in different legal texts. In these circumstances, a common objective of CIT

reform is to increase the transparency of the tax law. This requires avoiding the dispersion of the tax laws. In addition, it requires that taxation rules are certain and clear to the taxpayer. The results of increased transparency are a higher level of certainty for the taxpayer and the reduction of administrative costs for the tax authorities and compliance costs for the taxpayers.

Coordination with Financial Accounting Rules

The tax base of the CIT is the amount of the income generated by the firm during the fiscal year. For the majority of taxpayers, this income is calculated as the balance on the profit and loss account regulated by the Commercial Code, the Corporation Law and the General Accounting Plan.

However, income calculated by accounting principles may not be the same as that defined as the tax base of the CIT. This divergence is generally due to the different objectives of the accounting and fiscal legislation. Nevertheless, one of the objectives of CIT reform has been the better coordination of the tax laws with accounting rules. This has meant the acceptance of accounting principles as a tool for taxation, and in more practical terms, working out the concept of taxable income from an accounting result corrected by clear and exact adjustments. These adjustments have been limited to a minimum so as to achieve the parallelism between accounting and fiscal definitions. This proximity between tax and book profit enhances compliance by taxpayers, providing them with greater certainty and reducing conflict with the Tax Administration.

Among the measures to pursue these objectives, we highlight:

- Book profit needs to be the starting point for the calculation of the tax base.
- Differences between book profit and tax base have to be regulated clearly and exactly whenever a discrepancy between both of them can be justified.

Exhaustive and over-detailed regulations of every component of the tax base (incomes, expenses, valuation criteria or timely criteria) should be avoided.

- Fiscal rules should avoid controlling purely accounting aspects.

Coordination with the Personal Income Tax

The CIT in essence is a withholding tax on the capital income that individuals obtain through their participation in legal entities. For this reason, any type of reform of the Personal Income Tax necessitates adaptation of the reforms to the CIT in order to maintain the unity and coherence of personal taxation on income. The need to choose the appropriate method of correcting for the double taxation of dividends and capital gains points us to the types of actions necessary for proper coordination between the CIT and the Personal Income Tax. Other measures needed for the proper coordination of these two taxes include the following:

- Regulation of the facts which affect both taxes following unitary criteria.
For example:
 - Taxable event definition
 - Regulation of shareholder- firm operations
 - Taxation of non residents
 - Definitions of capital incomes and withholding obligations.
- Discouragement of tax arbitrage with measures like:
 - Avoiding a significant difference between the CIT rate and the highest marginal tax rate of Personal Income Tax.
 - Approximation of the fiscal treatments of non-corporate and corporate enterprises.

The Content of the Reforms

The aim of this section is to describe the essential features of the reforms of the CIT in Spain over the last 25 years by analyzing the principal elements of the tax. The discussion will focus on those elements that have a major influence on the effective rate of taxation of corporate income. For reasons of space we will make only reference to the most representative reforms.

Nominal Tax Rate

The Corporate Income Tax, born in 1978, was designed as a proportional tax with only one tax rate, whatever the destination of the profit. This principle was fundamentally respected in the later reforms and it agrees with the experience of most of the countries of the European Union.

The general rate, initially established at 33 percent, was increased to 35 percent in 1983 and it has been kept at that level since then. Besides, there has been special tax rates applied to certain types of companies¹¹.

Measuring the Tax Base

This is the most complex of all steps in levying the CIT. For clarity of exposition we decompose this issue into several themes.

Relation to Accounting Profit

One of the main criticisms directed to the establishment of the CIT 1978 and to its later developments was its lack of coordination with general accounting rules. One of the problems was that the Regulations on the CIT produced a proliferation of new “accounting” rules and in such a way that, in practice, they took precedence over the non-fiscal rules.

In this context, one of the main innovations of the 1995 reform was the calculation of the tax base from the general accounting results adapted for fiscal purposes with clear, precise and a limited number of adjustments. These adjustments answer, for example, to accounting expenses that are not tax deductible (fines and penalties, interest incurred on share capital, corporate income tax); or to accounting income not taxed, as some foreign incomes that are exempt to correct for international double taxation. Besides, the adjustments can be caused by differences in the time criteria, as accounting provisions and amortizations higher than the tax limits, or tax amortizations higher than the accounting ones because of the application of tax incentives as the accelerated depreciation.

Amortization

The amortization methods contained in the 1978 Law continue to be in force at present. The general system is the straight-line method based on official tables, which consists of writing off every asset according to a percentage included between the maximum and the minimum indicated in the tables. Besides, the declining-balance method and the sum of the years digits method are applied with certain conditions. In general, these methods are more favourable to taxpayers than the straight-line method, because they allow advancing the tax amortization and to postpone the tax due. However, they can not be applied to buildings, furniture and tools.

The most important criticism directed to the CIT in the area of the amortization, was the high degree of obsolescence of the official tables, which basically dated back to 1965. As a response to this criticism, new tables of amortization were approved in 1993; these tables continue to be in force at present. Though the new tables offered higher maximum rates for some assets, the most general characteristic, applicable in all the cases, was the expansion of depreciation brackets. So, for a certain maximum

rate, the maximum number of years was increased, and thus, reducing the minimum rate and extending the bracket of depreciation rates allowed.

Until 1995, there was no minimum unit cost below which assets might be written off in the year in which they were acquired. This rule was introduced in the 1995 reform, but only for small and medium-sized companies. Another innovation in the 1995 reform was the amortization of intangible assets. The 1995 reform allowed the amortization of goodwill and other intangible assets, provided that they had been acquired from non related parties. A straight-line method was established over a maximum period of 10 years, though from 2002 onward, the annual maximum rate for the goodwill has been lowered to 5 percent.

Loss Offset

The 1978 reform established a five-year limit on the carry-forward of loss offset against profits. With the passage of time, this term came to be considered as very limiting, not only for equity and neutrality reasons, but also because of the progressive amplification of the loss offset in countries in Spain's economic environment. For this reason, the 1995 reform extended the term of offsetting losses to 7 years, and later reforms extended it to 10 years (from 1999) and to 15 years (from 2002).¹² In no case the Spanish Corporate Tax has allowed carry-back provision, despite the fact that this possibility has been incorporated, though in limited ways, in the tax codes of some other countries.

Adjustment to Inflation

Because the CIT is a proportional tax, the inflation affects mainly the calculation of the taxable base. With a tax base calculated on the basis of nominal values, inflation can lead to a monetary profit, which does not reflect the true income or taxpaying

capacity of the firm. Levying the tax on nominal profits tends to reduce the horizontal equity and economic neutrality of the tax. This effect seems to be confirmed, in the Spanish case, by several empirical studies (see section 5.2).

The basic components of the taxable income which are affected by inflation are amortization, capital gains, stock valuation, and the taxable and deductible interests. We now proceed to review the responses of the Spanish Corporate Tax to these matters.

a) Amortization

The Spanish CIT defines the depreciable base as the historical cost of acquisition or production. In times of inflation this method generates tax liability on monetary profits, which in real terms do not reflect the true individual taxpaying capacity of the firm.

Neither the 1978 Law, nor the later reforms, not even the 1995 reform, applied a formula to adjust the calculation of depreciation in line with inflation with general and regular character. Instead, the possibility of revaluation of assets has been used as a technique for partial adjustment. Specifically, for the fiscal years 1979-1981, 1983 and 1996 the revaluation of fixed assets was allowed according to legally established coefficients. The accounting surplus generated with these revaluations was not taxed.

b) Capital gains.

The 1978 Law made capital gains taxable at the moment of their realization. In general, the taxable capital gain was the amount by which the proceeds from the sale of the asset exceeded the cost of acquisition. In some years, the revaluation of assets mentioned in the previous paragraph was allowed as the only technique to correct for inflation.

The 1995 reform introduced a mechanism of monetary correction of capital gains. Interestingly this was done in spite of the fact that there were very few other countries that were trying to correct this problem. The correction mechanism was applicable in the transmissions, both onerous and lucrative, of tangible and intangible assets. In the calculation of the taxed capital gain, the financial structure of the company was borne in mind in the sense of reducing the degree of inflation correction as the company was increasingly financed with debt. This type of monetary correction of capital gains was eliminated in 1999 and at present, it's only applied in the case of transfer of immovable property.

c) Stock (inventory) valuation.

The Corporate Income Tax introduced in the 1978 reform allowed stock valuation according to the average cost and the FIFO methods. Nevertheless, it prohibited the application of the LIFO method and of any other one based on the replacement cost. In the presence of inflation these rules generated artificial profits and an unfair burden of taxation.

The 1995 reform extended the number of methods allowed for inventory or stock valuation for tax purposes. This was one of the aspects of the reform in which there was a high degree of agreement between theoretical principles and findings in empirical studies. These studies routinely showed a higher rate of effective taxation associated with inventories vis-à-vis other company assets (see section 5.2). Besides these changes were also justified by the recent evolution of the fiscal systems of countries in Spain's economic environment.

In fact, the 1995 Law did not include any specific rule regulating inventory valuation. However, in view of the new model of relating the book profit and taxable income in the 1995 reform, a company may use, for tax purposes, any of the valuation

methods which it has applied in its commercial balance sheet, included the LIFO method.

d) Taxable and deductible interest

The Spanish CIT as allows, a deductible expense, the nominal amount of interest paid on loans, and requires the inclusion as income interest payments received also for its nominal amount. A process of inflation increases the volume of nominal interests paid and received, creating opposing effects on both sides of the balance sheet and in lenders and borrowers. There is an increase in the tax due by creditors because their taxable base increases; and there is a decrease in the tax due by debtors because their deductible expenses as financial charges increase.

This effect of inflation has not been corrected for in the Spanish CIT, according to the international experience with this issue. However, as we pointed out above, currently the CIT takes into account the financial structure of the firm in the calculation of capital gains. This can be considered as a method, though partial and imperfect, of taking into account the advantages of debt financing of assets in inflationary periods.

Incentives to Investment and Employment

The 1978 reform established different instruments within the CIT with the purpose of stimulating private investment. Some of these instruments were to act through a reduction in the taxable base, such as in the case of the exemption of capital gains or accelerated depreciation provisions; others, such as in the case of investment credits, they were to work by directly reducing the tax liability.

This scheme of incentives was one of the aspects of the Spanish CIT that received most direct criticism. Its shortcomings were apparent in terms of lack of effectiveness and neutrality, administrative complexity and high collection costs. The

same shortcomings had been detected in other countries and had led to fiscal reforms characterised by a reduction in general incentives and keeping or even promote specific incentives to certain areas or activities.

Spain was not isolated from these reform trends, even before the 1995 Law. As examples we can mention the suppression of tax credit for securities in 1982; the progressive reduction of the percentage of tax credit for new tangible assets¹³; the elimination, except for handicapped personnel, of the tax credit for employment; and the creation or improvement of deductions as the one related to exporting activities, employee training or R&D activities.

The 1995 reform introduced, as a principal innovation, the elimination of the tax credit for new tangible assets as a permanent fiscal incentive, though the Budget Laws should be able to restore it on a temporary basis for economic stabilization purposes. This power was only used in 1996.

Accelerated depreciation survives but with a very selective application. For example, under certain conditions, mining assets, the assets of Labour Companies and certain expenses and assets used in R&D activities can be freely amortized.

The 1995 Law maintained the incentive to reinvest profits with important innovations. The most remarkable one was the substitution of the exemption formula for the deferral of capital gain according to the recommendations offered in the Ruding Report¹⁴ and the experiences of other countries in this regard, so that, the non-taxed capital gain in a given period had to be included in the taxable income in future years. Another innovation was that the transferred assets and those in which the proceeds had been reinvested could be not only tangible and intangible assets, but also shares or other participations provided that they formed a holding of at least 5 percent in any entity.

The deferral regime was removed in 2002 and replaced by a fiscal credit for reinvestment. The general percentage of deduction at present is 20 percent. So, in the case of reinvestment, capital gains, instead of the general rate of 35 percent, pay an effective tax rate of 15 percent, which is the same rate that is applicable in the Personal Income Tax to the capital gains generated in periods exceeding one year.

As we have already indicated, a characteristic of CIT reform in Spain has been the improvement of the specific incentives. These incentives have the goal of correcting market failures and they must have a selective and permanent nature. This fact justifies their incorporation in the CIT Law. In Spain these incentives are driven mainly through credits (deductions from tax liability) and they include the following:

- a) Research, development and innovation activities.
- b) Exporting activities
- c) Investments in cultural assets, new film productions and new books.
- d) Investment for environmental protection.
- e) Expenses in training personnel
- f) Handicapped personnel employment.

Some of these deductions have been introduced after the reform of 1995, but others (a, b, c and e) existed even before this date. The analysis of the evolution of the latter deductions shows the improvement of the incentives with an increase in its generosity. This effect is particularly intense in the fiscal credit for R&D and innovation. To be emphasised also is the recent introduction of a measure with a specific objective of promoting outbound investment. This is a deduction from the taxable base with deferral to stimulate the establishment of companies abroad.

To conclude, the establishment of a special regime for small and medium sized companies needed to be outlined in the 1995 reform. Since then, the concept of

"Small and medium-sized company" has been an object of multiple reforms. All of them have tended to extend the area of application of the special regime in order to have more companies enjoying the incentives provided to this type of company.¹⁵ Among these incentives stand out especially diverse modalities of accelerated depreciation and the application of a reduced tax rate of 30 percent¹⁶. Besides, a tax credit exists for new data processing technologies.¹⁷

Relief from Economic Double Taxation

The 1978 Law corrected the double taxation of dividends through a mechanism of partial integration at the shareholder level. In particular, a variant of the credit system was applied. The shareholder was including in his taxable income the dividend received, and was deducting from the tax liability an amount that in no way was directly related to the corporate tax paid by the company distributing the profits. Concretely, the individual shareholder was deducting 15 percent of the dividend received and the corporate shareholder was deducting 50 percent of the proportional part of his quota derived from the dividend. However, where there was a parent-subsidary relationship (shareholdings of at least 25 percent), dividends received from national subsidiaries were usually tax exempt.

The criticism addressed to the weak mitigation of the double taxation that this system was providing, gave rise, paradoxically, in 1985, to a reduction of the deduction in the case of an individual shareholder from 15 to 10 percent.

The 1995 reform increased the degree of correction for economic double taxation. A variant of the credit system continued to be applied. To the corporate shareholder, the most prominent innovation was the amplification of the full correction for double taxation to a holding of at least 5%, and the correction for double taxation of capital gains with certain conditions. On the other hand, the

"estimated imputation system" was chosen for the individual shareholder. This method consists of adding, to the taxable base of the Personal Income Tax, the sum of the dividend received plus an estimation of the CIT in relation to the dividend. This estimated CIT is deducted from the tax liability. In general, the CIT is estimated at 40 percent of the received dividend. The correction for double taxation would be full if the effective tax rate in the CIT were 28.57 percent¹⁸.

Another system that, from the theoretical point of view, is useful to correct the economic double taxation is the "tax transparency", according to which the profits generated in certain corporations, both distributed and retained, are taxed as part of the shareholder's income tax.

This regime was introduced in the Spanish tax system by the reform of 1978 under two modalities: voluntary and compulsory. Only the voluntary tax transparency, applicable to certain small and medium - sized companies, had the purpose of removing the double taxation problem. On the contrary, the compulsory tax transparency, applicable to certain portfolio and fixed investment companies and to professional companies, had the purpose of preventing tax avoidance through the creation of conduit companies. In that time in Spain, there was a difference of more than 20 points between the corporate tax rate and the highest marginal tax rate for Personal Income Tax. This fact was clearly inciting the creation of conduit companies for tax avoidance purposes, since the dividends distributed to corporations were paying a lower tax rate than those distributed to individual shareholders with high income levels. The regime of compulsory tax transparency was justified as a method of avoiding this type of behaviour.

After the fiscal reform of 1985, the voluntary tax transparency was eliminated, despite the criticism from most of the studies on this subject. On the other hand, the

compulsory regime was kept, but only positive taxable bases were imputed. The negative taxable bases were compensated in the transparent company according to the general criteria of the CIT. Thus, tax transparency turned into a sanctioning regime for these companies.

The 1995 Law keeps the compulsory character of the transparency regime, but with important innovations. The most important one is that the transparent companies are subjected to the general tax rate in the CIT. On the other hand, shareholders continue to include, in their taxable income, their share in the positive taxable base of the company. In the recent past, the transparency regime has been subjected to a barrage of criticisms of a diverse nature. The regime has turned out to be excessively complex for the Administration and the taxpayers and it has not always managed to avoid the evasive use of conduit companies. The regime could have also reduced the attraction to the corporate legal status, which is the preferred juridical form in a market economy. Besides, the approximation of the corporate tax rate and the maximum marginal tax rate of Personal Income Tax reduces attraction to the interposition of conduit companies.

All these criticisms have caused the removal of the tax transparency regime in 2003. The professional companies are now taxed according to the general regime of the CIT; and the portfolio entities and the fixed investment companies are taxed with the new “State Companies Regime”. In this regime the taxable income of the company is divided, in accordance with the regulation of the Personal Income Tax, in two parts. The general part is taxed at a rate of 40 percent, which is five points over the general corporate tax rate to prevent the use by individuals of the state companies without business activity. The special part pays 15 percent and it applies to long term capital gains.

International Aspects

There are two problems of a fiscal kind caused by the economic internationalization process in the presence of tax differences between countries. They are international double taxation and international tax avoidance.

Relief from International Double Taxation

The topic of relief from international double taxation is among those that have generated most changes in the regulations of the CIT in the recent past. These legal changes can also be read as the position taken by the Spanish authorities in the discussion of what is the best method to address international double taxation: exemption or credit?

The 1995 Law, in clear continuity of some previous rules, chose the credit method with limitation to correct both juridical and economic double taxation. The credit method allows for the deduction of taxes paid abroad from the tax due in Spain, if such amount is lower than the tax paid in the Spanish CIT for the foreign income. This method survives with some change in the current regulations and practice, but as we will explain immediately below as residual or default method.

A chief reason for having chosen this option has been the desire to achieve capital export neutrality. Actually, with an imputation system, two domestic residents with the same worldwide income would pay the same taxes whether that income comes from domestic or from foreign sources. Nevertheless, this advantage might be invalidated if a limitation to tax credit is established. Concretely, if the tax rate in the source (importing) country is higher than the tax rate in the resident (exporting) country, the whole tax paid abroad will not be allowed as a credit, so that the international double taxation will not be fully corrected. The resident investor will be

subjected to the effective tax rates of the source country, and therefore, capital export neutrality will not be achieved.

If the limitation to tax credit does not take effect because the source rate is lower than the residence rate, the main problem remaining with the credit method is the loss of competitiveness of the residents who compete in the foreign markets. Actually, the resident investor would be subjected to the tax rate in the residence (exporting) country that would be higher than the rate of the competitors in the source (importing) country.

In 1996 the exemption method was introduced in the Spanish CIT. This method is, under certain conditions, applied to dividends and capital gains generated in foreign subsidiaries and to the income obtained through permanent establishments located abroad. If there is a limitation to the tax credit, the exemption method is equal or better from the view point of the taxpayer than the imputation method. So, although at present both methods coexist, the credit is a residual regime applicable when the requirements to exemption are not fulfilled.

This more recent change of trend in the Spanish tax system in favour of the exemption method is due to the legislators' goal of supporting the internationalization of the Spanish companies. The exemption method, which supposes the exclusive burden of the income in the source country, allows the companies to compete in the same conditions (for tax effects) in international markets. There are, therefore, reasons of international tax competition that explain the current preference for this method to correct for international double taxation. Besides, it is easier than credit method. Finally, as we pointed out before, the exemption method achieves capital import neutrality but not capital export neutrality¹⁹

Methods of Reducing International Tax Avoidance

The CIT law and the Spanish Tax Administration have adopted different methods to try to prevent international tax avoidance schemes. For example, on transfer prices, the CIT law demands to value the operations between related companies in accordance with the arm's length principle, without admitting opposite proof. Nevertheless, in order to increase the certainty to the taxpayer, the reform of 1995 took into consideration the possibility that the taxpayer carries out a proposal for the valuation of related transactions before their realization. On the other hand, the reform of 1995 established a thin capitalization rule in order to avoid the abuse of the debt between related entities, in such a way that the interest payments considered excessive will be considered of dividends for tax purposes, and therefore will not be a deductible expense.

International Tax Transparency is another anti-tax avoidance method used by the Spanish CIT since 1994. This consists of including some positive incomes obtained by non-resident entities in the taxable base of the resident entities. Its aim is to prevent the advantages of using conduit companies in foreign territories with low taxation to avoid or to postpone the payment of the Spanish tax.

Besides the mentioned measures, we might consider the fact that the CIT Law is sprinkled with articles in which cautions are established with regard to tax heavens. On the other hand, the extension and improvement of the bilateral tax treaties signed by Spain must be labelled not only as a mechanism to correct international double taxation, but, also, as a way of tax coordination with other countries to prevent incomes avoidance practices.

The Performance of the Spanish Corporate Income Tax in Terms of Tax Revenue, Neutrality and Competitiveness

Tax revenue

This section reviews the revenue performance of the CIT in Spain vis-à-vis other countries in the OECD.

Tables 1 and 2 show the quantitative importance of the Corporate Income Tax during the period 1965-2001 using two indicators - Corporate Tax as percentage of GDP (CT/GDP) and Corporate Tax as percentage of total taxation (CT/ TT). Three areas are analysed: OECD, European Union (15) and Spain.

The Corporate Income Tax evolution during the analysed period finds its main explanation in the economic environment evolution, although we have to consider legal changes, which can explain the figures in certain periods. For example, tax revenue increases in 1983 and 1985 can be explained by the increment of the nominal tax rates and the reduction of incentives, respectively.

CT/GDP index (table 1) is, in general, lower in Spain than the average of the OECD and EU (15). Until the late 80s the weight of the Corporate Tax in GDP in Spain is approximately 60% of the other two areas analyzed. However, since 1987 the figure has been getting closer, and in the 90s the percentage gets around 80% of the levels in the other two areas analyzed in this section.

CT/TT index (table 2) is, in general, lower in Spain than the OECD average. Comparison with UE (15) shows, with some exceptions, that the CT/TT index is higher in Spain in the period before 1978 reform and lower in the period after the reform.

Table 1. Corporate Tax as Percentage of GDP

| | 1965 | 1970 | 1975 | 1980 | 1985 | 1990 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| OECD | 2.2 | 2.4 | 2.2 | 2.4 | 2.7 | 2.7 | 2.9 | 3.0 | 3.2 | 3.3 | 3.3 | 3.6 | 3.5 |
| European Union (15) | 1.9 | 2.1 | 2.1 | 2.1 | 2.6 | 2.6 | 2.7 | 3.1 | 3.4 | 3.5 | 3.5 | 3.8 | 3.6 |
| Spain | 1.4 | 1.3 | 1.3 | 1.2 | 1.5 | 2.9 | 1.8 | 1.9 | 2.6 | 2.5 | 2.8 | 3.0 | 2.8 |

Source: OECD (2004): Statistical Compendium.

Table 2. Corporate Tax as Percentage of Total Taxation

| | 1965 | 1970 | 1975 | 1980 | 1985 | 1990 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| OECD | 8.8 | 8.8 | 7.5 | 7.6 | 8.0 | 7.9 | 8.0 | 8.3 | 8.8 | 8.9 | 8.8 | 9.7 | 9.6 |
| European Union (15) | 6.7 | 6.9 | 6.0 | 5.8 | 6.4 | 6.8 | 6.9 | 7.7 | 8.5 | 8.7 | 8.7 | 9.2 | 8.6 |
| Spain | 9.2 | 8.2 | 6.9 | 5.1 | 5.2 | 8.8 | 5.4 | 5.8 | 7.8 | 7.3 | 8.0 | 8.6 | 8.1 |

Source: OECD (2004): Statistical Compendium.

Neutrality and Competitiveness

This section shows the main results of the empirical studies on effective taxation, which analyse the degree of fulfilment of the neutrality and competitiveness principles of the Spanish CIT.

a) Internal neutrality of the Spanish CIT

The studies that have analysed the internal neutrality of the Spanish CIT have quantified the effective tax rates of different investment projects, deducing the presence or absence of neutrality from the analysis of the dispersion among the tax rates. Though there have also been studies that calculate effective average tax rates, most of the studies have calculated effective marginal tax rates applying the King and Fullerton methodology (King, M. and Fullerton, D., 1983)²⁰. Among the latter works, there are important methodological differences. For example:

- Period to which the results refer.
- Variables of classification of the results: assets, source of finance, activity sector, firm size, legal status or location area.

- Specifics methodological assumptions for the calculation of the different variables.
- Effective taxation indicator: effective marginal tax rate, cost of capital and tax wedge.

Nevertheless, in spite of these methodological differences, it is possible to summarize the principal conclusions of these works.

Espitia, M. and others (1989) and Paredes, R. (1992) quantify effective tax rates on the marginal investment for types of assets, taking into account, exclusively, the influence of the CIT. These studies differ in the assumption about the source of finance of the marginal investment. The first study considers a combination of internal and external financing; and the second one, considers exclusively internal financing. Though they refer to different periods²¹, they agree in their findings about the scanty neutrality of the Spanish CIT with the relative treatment of the different assets. The buildings and, especially, the stock are the assets with the highest effective tax rates, whereas the investment in machinery and vehicles is subjected often to negative effective tax rates that show that these assets receive a marginal subsidy to the investment. Besides, in a historical analysis, Espitia and others conclude that the introduction of the CIT in 1979 supposed a general reduction of the effective tax rates, due to the establishment of tax incentives for investment, and a great dispersion of the marginal effective tax rates applicable to the different assets.

More recently, Paredes, R. (2002) has compared the effective tax rates by type of asset in 1989 and 2001. The results show an increase of the effective tax rates for all the assets with the exception of stock. The increase is such that machinery and vehicles reach positive effective tax rates due to the elimination of the general tax credits for the investment. The effective tax rate for stock is reduced due to the

admission of the LIFO system for inventory valuation. The buildings are the assets most penalized fiscally. Besides, there is an observed reduction in the dispersion of effective tax rates among assets between 1989 and 2001. This reduction shows a substantial improvement in the neutrality of the Spanish CIT in the relative treatment of the different assets during the last decade.

Other studies, also related to the Spanish case, analyse the joint effect of the company and individual income taxes. They refer the results, not only for assets, but also for sectors, source of finance, firm size, location area or legal status of the firm²². Though methodological differences exist among them and they refer to different periods²³, we might emphasize some general conclusions:

- The combination of the CIT and of the Personal Income Tax generates a tax structure that imposes a burdens, of very unequal form, on the capital income of different investment projects.
- For type of asset, stock is the asset most penalized fiscally, while machinery and vehicles receive the most favourable treatment²⁴.
- From the financial perspective, the debt receives the best tax treatment. Inside the internal financing, the retained earnings have a comparative advantages relative to the issue of new shares.
- In the sectoral field, a dispersion exists among sectors is observed²⁵.
- The calculations for the firm size show that big companies face lower effective taxation than small and medium sized ones.

An interesting question is knowing what influence inflation has had on the effective taxation on the Spanish companies. From a theoretical point of view, it is not possible to do conclusive affirmations on this matter. There are different factors that can act in opposite directions. For example, the over-taxation that of a fixed asset

whose amortization is calculated from the historical cost can be compensated if this investment is financed by debt, due to the possibility of deducing the nominal interests. For all this, the empirical analysis is necessary.

The empirical studies done on the Spanish case²⁶ conclude that, in general, inflation increases effective tax rates of all investment projects²⁷. Besides, the sensitivity to price inflation is very different among the different projects, which worsen the lack of internal neutrality of the Spanish CIT.

b) International tax competitiveness.

As we have already indicated, the CIT, as a cost component of the company, can be a factor in determining competitiveness. Actually, if a resident company in Spain was subjected to an effective tax that is higher than for resident companies in other countries, the Spanish company would be in a competitive disadvantage relative to foreign companies with which it has to compete on the international market. For this reason it is important to know the level of effective taxation in Spain and to compare it with the levels in the surrounding countries, particularly in the European Union.

There are numerous studies that calculate indicators of effective taxation in different countries²⁸. Studies that do calculations for countries of the European Union refer to different periods and offer methodological differences. As such, they are not always comparable. Nevertheless, they seem to show that Spanish companies are more taxed than the average European company. This conclusion is independent of the indicator of effective taxation used, and is a common one, though with some exception, in the analyses for the type of asset and for the source of finance. As an example, we can mention, for its major current importance and for its methodological contributions, the Report "Company Taxation in the Internal Market" (European Commission, 2001)²⁹. This report concludes that in Spain, the cost of capital, the

effective marginal tax rate and the effective average tax rate, are higher than the average of the European Union³⁰. In an ascending order of tax rates, Spain is in the twelfth position in regard to the marginal tax rate; and in the ninth position in regard to the average tax rate. This major value of the indicator of effective taxation is produced for all the assets and sources of finance with the only exception of stock in the case of the average tax rate, and of the stock and machinery, in the case of the marginal rate and the cost of capital.

On the other hand, it would be interesting to know how the effective taxation of the CIT in the countries of the European Union has evolved during the past years and the changes in the relative position of Spain. Work by Paredes, R. (2002), which calculates effective marginal tax rates for CIT for type of asset in for the years 1989 and 2001, can shade some light to this matter. The results show a reduction in the effective marginal tax rate of the average European company, and a reduction of the dispersion of the tax rates among countries.

Spain, departing from an effective tax rate higher than the European one in 1989, has experienced a lower reduction. This shows the loss of competitiveness by the Spanish companies in the framework of the European Union during the nineties if we isolate the influence of the CIT. This deterioration of the competitive of Spanish position in the European Union is holds for all the assets with the only exception of stock.

c) International tax neutrality

An empirical analysis of international tax neutrality needs to calculate the effective taxation, not of the domestic investment, but of the transnational investment. It is a question of knowing the tax treatment of the investments located in a country, and that are realized by residents in other countries. There are numerous studies that have

made this type of calculations³¹. We can point out, again, the Report "Company Taxation in the Internal Market" (European Commission, 2001)³². We are interested in knowing the results of this Report for the Spanish transnational investment for two reasons:

- To know the tax treatment of Spanish investment in different countries in the European Union and the degree of capital export neutrality.
- To know the tax treatment of foreign investment in Spain and the degree of capital import neutrality.

The analysis of the degree of CEN from the Spanish perspective shows that the Spanish tax system does not achieve the CEN. On average, domestic investment in Spain is more taxed than Spanish investment abroad. This result occurs when the subsidiary is financed, exclusively, by retained earnings or new equity. Nevertheless, in the case of debt finance, domestic investment receives a more favourable tax treatment.

As for the countries in which, from a tax point of view, it is more appealing to establish subsidiaries of a Spanish parent, it is observed that it turns out to be particularly profitable to locate a subsidiary in Ireland. Other attractive destinations include Sweden, Finland and United Kingdom. On the other hand, subsidiaries in Germany and France would be the most taxed in relation to the Spanish domestic investment. In this analysis of the relative position of the countries, an extraordinary parallelism has been observed by the arrangement obtained for domestic investment. There is a proximity, which in some cases transforms in identity, in the values of the cost of capital (or effective average tax rate) for both types of investment - domestic investment in the countries of the European Union, and transnational investment of a Spanish parent in the same countries. All this seems to indicate that the tax system in

the country of location of the subsidiary is the main determining factor of the effective taxation imposed on the investment of the Spanish parent in European Union countries.

The analysis of the degree of CIN from the Spanish perspective shows that the Spanish tax system does not achieve the CIN. On average, foreign investment in Spain is more taxed than domestic investment. For source of finance of the subsidiary, the previous result holds for debt finance. Nevertheless, the lack of CIN occurs in the opposite direction when the subsidiary uses the other two sources of finance (retained earnings and new equity) as the domestic investment turns out to be more taxed.

In an analysis of countries, it is observed that the parent companies from different countries of the European Union that has a subsidiary in Spain will not be subjected to the same effective tax. Different results are obtained for different indicators of effective taxation. The results for the cost of capital show that the Spanish tax system achieves the CIN for ten of the fourteen countries of the European Union, which include Austria, Holland, Luxembourg and Greece, the countries in which parent companies find it less attractive to invest in a Spanish subsidiary. On the other hand, the effective average tax rate shows that in the case of Germany the constitution of the parent leads to a lower tax burden, placing Greece, Holland and Austria in the opposite end. Besides, it seems to be the case, Germany being the principal exception, that there is an association between countries with low nominal tax rates in the CIT and countries with effective average tax rates below the average.

In short, the results of the Report of the European Commission show that the Spanish CIT does not achieve the neutrality in the international allocation of capital, but it provides a different tax treatment for domestic investment, for Spanish investment abroad and for foreign investment in Spain.

Conclusions and Final Remarks

Although the modern Spanish CIT introduced in 1978 represented an important step at the time, it rapidly faced criticism that put pressure on policymakers to reform it. The major reform of the CIT came in the 1995 Law, but before and after this major reform several partial changes of the tax took place. So, we can say that the CIT reform in Spain has been a constant process of adjustment, in an attempt by the legislators to “get it right,” but also as a response to the changing circumstances of the Spanish economy, especially the opening of the Spanish economy, and the inevitable internationalization of Spanish companies.

In this reform process, there has not been radical changes, which implied a transformation of the structure of the CIT established in 1978. Fortunately, this continuous reform process of the CIT has been generally informed by a common set of principles, although in each stage of the reform process some of them have been heeded more than others. These principles included: neutrality, competitiveness, international tax coordination, transparency of the tax law, coordination with financial accounting rules, and coordination with the Personal Income Tax.

In the context of open economies, the reform of corporate taxation should put more emphasis on the first three principles mentioned above. In the case of Spain, the process of increasing the openness of its economy in more recent years explains that the principle of competitiveness should have been the main basis for the reform of the CIT. Even the other two relevant principles in the context of economic globalization: neutrality and international coordination, have found their justification in terms of competitiveness.

In the third section of the paper, we examined the principles that the reform of the CIT should have followed, specially the ones with an international perspective, and the reforming measures that were justified in trying to fulfil these objectives.

Although the principle of economic neutrality has been increasingly respected in CIT reform, insofar as market failures exist, the CIT has been used in Spain to promote particular activities including R&D, employee training incentives, actions to support small and medium sized companies, promotion of the internationalization of Spanish companies, and helping company restructurings.

The last two mentioned measures also might be justified according to the international reports of company taxation³³ that propose to apply the necessary actions in order that the companies can take advantage of the Internal (Common European) Market. The Spanish authorities have put considerable effort in achieving the international coordination principle, as shown in the reforms and work dedicated to address the two problems of a fiscal nature that originated in the process of economic internationalization in the presence of tax differences between countries. These are the problems of international double taxation and international tax avoidance. Besides, in the international field, the international neutrality principle demands the application of correcting methods of international double taxation which serve to achieve the concept of neutrality that is considered a priority. The CEN support would imply credit methods; and the CIN support would imply exemption methods. In Spain, although at present both methods coexist, the credit is a residual regime applicable when the requirements to exemption are not fulfilled. There are reasons of international tax competition that explain the current preference to the exemption method.

The essential features of the most representative reforms of the CIT in Spain over the last 25 years were described in the fourth section. The main elements that have a major influence in the effective taxation have been analysed. Besides, the fifth section shows the main results of the empirical studies on effective taxation which analyse the degree of fulfilment of the principles of neutrality and competitiveness of the Spanish CIT. These studies coincide with the scanty neutrality of the CIT with the relative treatment of the different investment projects. Nevertheless, during the nineties, there has been a substantial improvement in the neutrality of the Spanish CIT in the relative treatment of the different assets.

The studies on international tax competitiveness seem to show that the Spanish company is more taxed than the average European company and they show a loss of competitiveness during the last decade. Finally, the Spanish CIT does not achieve the neutrality in international allocation of capital.

The fact that the CIT falls on such a changing reality, as the company is, makes us foresee that the reform process will continue in the future. The agenda for reform in the future has no doubt a greater effort to advance the approximation of the tax base to the concept of book profit. This, no doubt, will entail a major reconsideration of what are tax deductible expenses. For example, concerning provisions, it would be a question of accepting, in fiscal terms, what has been already accepted in the accounting field. In the area of amortizations, it has been proposed that the maximum amortization rates be increased to adapt them to the new managerial reality in which the assets have less and less useful life. Other proposed measures have been: extending the assets to which regressive methods can be applied; and generalizing the possibility of immediate amortization of small value assets.

On the other hand, the importance of going deeply into the reform of the international aspects of the CIT has to be outlined. Though methods can be adapted to unilateral level, the most effective action in this matter is the fiscal coordination with other countries, especially U.E. countries. Measures like the expansion of the area of application of the mergers and parent-subsidiary directives; the agreements about transfer prices or the signing of a multilateral tax treaty, are justified from this point of view.

We are going to finish with a final reflection on the process of fiscal competition in the European Union regarding CIT and its implications for Spain. This process, that has led to a moderate decline falling approximation of the CIT in Union countries, demands the consideration of the reform trends in the surrounding countries so that Spain is not placed in an unfavourable competitive position.

The relatively high effective taxation that the Spanish company carries in the European context, showed by some empirical studies, should make us think about reforms that tend to reduce the tax burden on the Spanish company. Though there are many elements which determine the effective tax rate, empirical work has demonstrated that the nominal tax rate is a particularly influential factor. So, a moderated reduction of the nominal rate would have a direct influence upon the reduction of the effective tax rate to ensure that it approaches the average of the European Union.

Besides the described one, there are other reasons that might support a reduction of the nominal tax rate of the CIT. The Spanish general rate of 35 %, invariable since 1983, though it was quiet low at the end of the eighties in the European context, at present, is above the average in Europe. This, together with the psychological effect

that it might have on the managerial decisions, seems to justify a reduction of the general tax rate by not less than two points.

Notes

1. Hereafter CIT.
2. From an economic point of view, only individuals are capable of paying taxes. Corporate entities are only a way to transfer income to individual shareholders.
3. It is considered that the first regulation of CIT in Spain was in 1900 with the Fernández Villaverde Fiscal Reform. After multiple reforms, in 1978 took place the modernization of this tax integrating it together with the Personal Income Tax into the Spanish Tax System.
4. See section 5.1.
5. Pure profits of a corporation is the net income over remuneration of all production factors, including capital. This must allow a deduction for an ordinary rate of return on corporate equity from the corporate income tax base. Cash-flow tax would levy the net cash flow from the corporate transactions. The taxable income would be worked out as the difference between the total corporate income (coming from goods and services profits), minus corporate goods and services purchases, including current and capital accounts.
6. Directive 90/434/EEC relative to the common tax regime applicable to mergers, spin-offs, asset contributions and share exchanges between companies in different member States; Directive 90/435/EEC relative to the common tax regime applicable to parent companies and subsidiaries in different member States, amended by Directive 2003/123/EC; Convention of 23-7-90 relative to the elimination of double taxation when correcting the profits of associated companies.
7. Some of the main reports are: European Commission (1992), OECD (1991) and some reports of European Commission as "Corporate Taxation in the Internal Market" (European Commission, 2001).
8. The exporting country is the country of the residence of the investor. Hereafter "Resident country".
9. The importing country is the country of the location of investment where the income originates. Hereafter "Source country".
10. Also it can be achieved with the exemption in the source (importing) country and the payment of taxes exclusively in the residence (exporting) country.
11. Hydrocarbon research and exploitation companies are subject to corporate income tax at a rate of 40 percent. The following reduced rates apply:
 - 25 percent for mutual insurance companies, rural and cooperative banks and credit cooperatives, non-profit organizations that do not meet the statutory requirements set out in Law 49/2002, professional associations and trade unions.
 - 20 percent for specifically protected credit cooperatives.
 - 10 percent for non-profit organization within the scope of Law 49/2002.
 - 1 percent for collective investment institutions.
 - 0 percent for pension institutions and funds.
12. Another innovation in the 1995 reform was the introduction of restrictions on the carry-forward of losses in the case of shares purchase in companies without business activity.
13. Reduction from 15 to 10% in 1987 and to 5% in 1989.
14. European Commission (1992)
15. From 2004 the maximum amount of sales turnover to this regime were applicable is 6 millions of euros.
16. This reduced tax rate was established in 1997 and it is applicable to the first 90.151,81 € of taxable income.
17. Until 1998, reinvested capital gains were exempted.
18. See calculation in Albi, E. (2001) and in the chapter in this book written by E. Albi..
19. The debate on the preference to CEN and the use of credit methods, or CIN and the use of exemption methods, is not closed. There are arguments in favour and against of each of these two options. For more details of this topic, see OCDE (1991). The main conclusions of the empirical studies that analysed CEN and CIN from the Spanish viewpoint are included in section 5.2
20. For an analysis of the advantages and disadvantages of the average and marginal effective tax rates, see Bradford, D.F. and Fullerton, D. (1981) and Fullerton, D. (1983).
21. Espitia, M. and others (1989) quantify effective marginal tax rates in Spain for the period 1965-1987, whereas that Paredes, R. (1992) quantifies the same tax rates, both in Spain and in the twelve community countries, for the year 1989.
22. Among these works we can emphasize: Cuervo-Arango, C. and Trujillo, J.A. (1986); Sanz, J.F. (1994); Domínguez, F. and Lopez, J. (1997 and 1999) and Romero, D. (1999).
23. For example, Cuervo-Arango, C. and Trujillo, J.A. (1986) refer to 1985; Sanz, J.F. (1994) to the period 1991-1993, Domínguez, F. and López, J. (1997) to 1996; Romero, D. (1999) to the period 1991-1994; and Domínguez, F. and López, J. (1999) to 1998 and 1999.
24. The higher effective taxation for the stock is common to all the studies that relate the results to periods before to the CIT Law of 1995.
25. The different works that realize sectorial analysis are not directly comparable because they realize different sectorial classifications. As example, we can mention Cuervo-Arango, C. and Trujillo, J.A. (1986) that emphasizes that the

- manufacturing sector is the one that supports a higher effective tax rate; and Sanz, J.F. (1994) that indicates to the sector food as the most marginally taxed.
26. See, for example, Cuervo-Arango, C. and Trujillo, J.A. (1986); Espitia, M. and others (1989); Paredes, R. (1992) and Sanz, J.F. (1994).
 27. According to Cuervo-Arango, C. and Trujillo, J.A. (1986) the only exception to this general result refers to the debt financed projects. The effective taxation of these projects reduces when inflation increases. This latter relation is not deduced of Sanz, J.F. (1994), though he concludes that debt is the source of finance least affected by the inflation, whereas the internal financing is the most sensitive to the price evolution.
 28. Among these works we can mention: Auerbach and Jorgenson (1980); Boadway, R.W., Bruce, N. and Mintz, J.M. (1982); Auerbach (1983); King, M. and Fullerton, D. (1983); King, M. (1985); Mckee and others (1986); Alworth, J.S. (1987); OCDE (1991); European Commission (1992); Paredes, R. (1992); Rodríguez, J.A. (1996); European Commission (2001) and Paredes, R. (2002).
 29. This study calculates effective average and marginal tax rates that burden domestic and transnational investments of 15 countries of the European Union in accordance with the tax system in force in 1999. The results are desagregated for five assets (intangibles, industrial buildings, machinery, financial assets and inventories), and three sources of finance (retained earnings, issue of new equity and debt).
 30. 6,5 opposite to 6,33 for the cost of capital; 22,8 percent opposite to 20,18 percent for the effective marginal tax rate; 31 percent opposite to 29,53 percent for the effective average tax rate.
 31. Among the works that, from King and Fullerton methodology obtain effective tax rates for the transnational investment we can mention: Crooks, E. and others (1989); Devereaux, M. and Pearson, M. (1989); Bovenberg, L. and others (1989); Frenkel, Razin and Sandka (1991); OCDE (1991) and European Commission (2001).
 32. In the context of the European Union, this Report supposes a parent company that invests in a foreign country across a subsidiary with a holding of 100 percent. Of the same way that in case of the domestic investment, it is supposed that the subsidiary can invest in five assets and can use three sources of finance. The parent company also can use these three financing sources.
 33. Such as European Commission, 1992 and 2001.

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