An evaluation of the 2014 fiscal reform: Insights from a survey of professional tax advisors

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A review of tax advisers' opinions over the recent tax reform indicates that changes are headed in the right direction in terms of eliminating distortions, mitigating tax planning, and reducing complexity. While the reform has not addressed all of the Spanish tax system´s shortcomings, the hope is that it will help sustain the Spanish economy's recovery and greater stability in the fiscal system.

There have been recurrent demands for fiscal reform in Spain in recent years, strengthened by the economic crisis. A reform was passed in late 2014, which entered into force in 2015 and 2016, and was concentrated on changes to the personal income tax and corporate tax regime. This article reviews the main features of this reform and attempts to identify the main shortcomings highlighted by tax advisors. In general, it is possible to conclude that the reform was a step in the right direction as regards addressing existing distortions/shortfalls, although there are areas that have not yet been addressed, such as the VAT and wealth tax.

Introduction

The Spanish fiscal system, like any other, is far from being perfectly fair, efficient and simple, with taxes that are exactly coordinated to finance public expenditure. Faced with this impossibility, economic analysis primarily focuses on applying taxes that can improve economic efficiency and, at the same time, foster a more just income distribution. This is because, although fiscal systems cannot be perfect, "the way in which they are designed is very important for economic well-being" (Mirrlees *et al.*, 2011, page 1).

Theoretical and empirical economic analysis offers an extremely useful toolkit with which to estimate the impact of taxes on the behaviour of economic agents. For example, public economy traditionally points to the importance of economic activities being taxed in the same way by the corporate tax and personal income tax (*e.g.,* Crawford and Freedman, 2010). The same applies in the case of business financing decisions, as interest on debt is tax deductible, whereas the opportunity cost of equity is not. Indeed, this lack of neutrality may have worsened the recent financial crisis (*e.g.* Slemrod, 2009; and Keen *et al*., 2010).

Consequently, academic literature shows there to be broad scope to achieve a fairer, more efficient and simpler fiscal system. However, if the aim is to achieve a better fiscal system, it would also seem worthwhile to consider the opinions of tax advisers. Drawing on their professional experience, how do they rate the possible sources

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of inefficiency in major taxes, such as the income tax and corporate tax? From their knowledge of the fiscal system, would they conclude that it is simple? Is the tax burden distributed fairly? In short, do they believe the Spanish fiscal system needs reform?[2]

With the aim of capturing their views, we prepared a questionnaire, which was distributed among tax advisers in late 2012. The answers received gave us their perspective on fundamental aspects of taxes, such as efficiency, simplicity and equity of the fiscal system as a whole, and in particular the system's two main taxes: the income tax and corporate tax. These are not regulatory opinions and may reflect certain biases, but they are of interest in studying taxation and can stimulate the debate on tax policies, with a view to improving them.[3] The responses can also be used as a benchmark against which to judge the recent tax reform.

Between 2015 and 2016 significant changes to the income tax and corporate taxes are due to come into force. These modifications affect the tax rates, and other relevant features with an impact on how tax bases and final tax liabilities are calculated. How should the changes brought by Laws 26/2014 and 27/2014 of November 27th, 2014, be viewed?

The rest of this article is organised as follows: The next section presents the findings of the survey of professional tax advisers. Subsequently, we discuss the main features of the tax reform passed in late 2014, and assess it in light of the survey findings. Finally, we offer some conclusions.

A survey of tax advisers on the Spanish fiscal system

The Spanish fiscal system mainly operates through a self-assessment mechanism, that is to say, taxpayers themselves report the taxable event giving rise to the tax (*e.g*. earned income), analyse the regulations and calculate their tax liability (*i.e.* settle their tax). For this reason, tax advisers play a particularly important role in the Spanish fiscal system, as they often help taxpayers comply with tax legislation. Their first-hand knowledge of the system makes their opinion of how it operates very relevant. To this end, in late 2012, we surveyed tax professionals throughout Spain, asking them questions that had traditionally been reserved for academia.[4] Our aim was not to ascertain tax advisers' individual preferences, but to draw upon the knowledge they have obtained from their daily professional practice to infer the extent to which some of the issues identified by academia should or should not be considered deficiencies or shortcomings, and, therefore, merit reform. We describe the content of the survey and discuss its main findings below.

The efficiency of the Spanish fiscal system

The questionnaire included a number of questions aimed at ascertaining Spanish tax advisers' opinions about the efficiency of Spain´s fiscal

[2] The academic literature includes examples of surveys sent to professional tax advisers in order to gather their opinions on tax policy. For example, the *American National Tax Association* sent its members a survey in 1994 that included a subset of questions on the U.S. fiscal system that university professors specialising in public finances had been asked back in 1934. (Slemrod, 1994). More recently, the same association again sent its members a similar survey in 2013.

[3] This same hope was expressed by Slemrod (1994) when analysing the results of the survey of U.S. tax professionals by the *National Tax Association*.

[4] The survey was conducted in collaboration with the two main Spanish associations in the tax advisory field, the *Asociación Española de Asesores Fiscales* (AEDAF) and the *Registro de Economistas Asesores Fiscal* (REAF). Nevertheless, the survey stated that its aims were academic and that it was being run and analysed by the Instituto de Economía de Barcelona (IEB), a research institute. The questionnaires were distributed on-line (www.EncuestaFacil.com) and the replies were anonymous, although the IP address was used as a filter to avoid multiple replies being sent from the same computer. A total of 272 completed replies were obtained. To identify possible bias, questions were also asked about respondents' personal characteristics and aspects of their work directly relating to the firm they work for. For more information about the survey, see Durán Cabré and Esteller Moré (2014).

system. Unlike the case of fairness, where it is the *set* of taxes that should be progressive, from the point of view of efficiency, it is socially desirable that each tax be efficient individually.[5] With this in mind, we asked about the possible distortions in the two main direct taxes, income tax and corporate taxes.

- Specifically, the questionnaire asked about the possible impact of the corporate tax on the following business decisions:
  - Source of *financing* chosen (debt or equity).
  - Type of *investment* to be made (depending on tax-deductible depreciation).
  - *Country* in which to invest (differences in tax rates).
  - Company legal *structure* (manner in which business is legally organised).
  - Tax *planning* to pay less (tax avoidance practices).
- In the case of income tax, the questionnaire includes the following topics relating to taxpayers' decisions:
  - Legal *structure* of the activity (creation of companies).
  - Autonomous region of *residence* (mobility).
  - *Home* purchasing rather than lease (to obtain the tax deductions on purchase of principal residence).
  - Types of *assets* used for savings.
- In the case of income tax, various questions were also included on the objective estimate or flat-rate scheme envisaged by legislation for small-scale economic activities, which also has an impact on the efficiency of the fiscal system:
  - Module-based objective estimation facilitates tax *fraud* (in income tax and other taxes).
  - Business owners who pay tax under this system *benefit* (as they pay less tax than they should according to their actual income).
  - Objective estimation is *simpler* than direct assessment.
  - *Elimination* of objective estimation and application of direct assessment as the sole assessment criterion would increase tax evasion.

There were four possible replies to each question, assigning each one a value: totally disagree, with a value of 1; agree somewhat, value 2; generally agree, value 3; and strongly agree, value 4. Table 1 shows the descriptive statistics for the responses given on efficiency, with items ordered from greater to lesser degree of agreement with the statement.

The average score for five of the questions was over 3, indicating a high degree of agreement with the issue raised. In these five cases, it is the fiscal system itself that is the source of the distortion, either because it facilitates tax evasion or because it allows taxpayers to pay less than they should based on their real income (modules), or because it gives rise to tax planning (organisation and planning of economic activities in income tax and corporate tax), or because it encourages people to buy their home (rather than rent). As a consequence, in relation to these five aspects, tax advisers' professional experience leads them to suggest that these two taxes represent a source of distortions, due to the features of the legislation governing these two taxes.

[5] A tax may sometimes be intended to correct negative externalities, in which case what is sought is an improvement in efficiency by correcting a socially harmful behaviour.

Table 1

Significance of distortions in the Spanish fiscal system

Variable	Observ.	Mean	Std. Dev.	Min.	Max.	Opinion
Income tax: Fraud using modules	272	3.500	0.778	1	4	
Income tax: Legal structure	272	3.379	0.778	1	4	
Corporate tax: Planning	272	3.316	0.756	1	4	**AGREE STRONGLY**
Income tax: Benefit from modules	272	3.140	0.894	1	4	
Income tax: Housing	272	3.051	1.000	1	4	
Corporate tax: Legal structure	272	2.923	0.928	1	4	**QUITE AGREE**
Corporate tax: Country	272	2.710	0.976	1	4	+
Income tax: Simplicity of modules	272	2.651	1.136	1	4	
Income tax: Residence	272	2.632	0.963	1	4	
Corporate tax: Financing	272	2.426	0.934	1	4	
Corporate tax: Investment	272	2.404	0.858	1	4	
Income tax: Assets	272	2.312	0.856	1	4	–
Income tax: Δ Fraud if modules eliminated	272	1.901	0.984	1	4	**DO NOT AGREE**

Source: Own elaboration.

The level of agreement on the other eight issues varies widely. In particular, there is a reasonable level of agreement that the corporate tax encourages the adoption of business legal structures, such that the legislation would again be a source of inefficiency. There is fairly strong agreement that the corporate tax determines what country to invest in, and Spanish income tax influences what autonomous region taxpayers choose to live in. These distortions are caused by the mobility factors, together with the decentralisation of income tax in the case of the latter. The degree of conformity is similar, *i.e.* more or less in agreement, when considering that the application of modules is simpler than direct assessment.

There is less agreement, with a tendency towards neutrality, that the corporate tax shapes the degree of financing from debt or equity and the types of investments made, or that the income tax determines the form of savings. These three issues are relevant precisely because they have been analysed in considerable detail by academic literature as sources of distortion. Finally, there was little agreement that eliminating the objective estimation system and applying direct assessment universally would result in an increase in tax evasion.

As a result, it is difficult to conclude how efficient the Spanish fiscal system is, but tax advisers' replies suggest that changes in the legislation –by eliminating distortions– may increase its efficiency, either by eliminating tax planning practices or discouraging changes in behaviour.

The complexity of the Spanish fiscal system (as a potential source of inefficiencies)

The very complexity of the fiscal system may indirectly constitute another source of inefficiency, insofar as it facilitates tax planning, for example, to exploit loopholes or inconsistencies in the fiscal system, of which there tend to be more the more complex the rules. However, complexity can cause efficiency losses directly, to the extent that it generates uncertainty (Giertz, 2012), or rather, adds greater certainty to that already existing in a market economy. For this reason, the survey also addressed the issue of the complexity of the fiscal system.

Specifically, tax advisors were asked: *Do you consider the Spanish fiscal system to be more complex than it was 5, 10, 15 or 20 years ago?* The answers in each case could be only Yes (=1) or No (=0). In this respect, whatever the time frame (5, 10, 15 or 20), the answers overwhelmingly reported greater complexity (the range was from 0.87 (taking the last five years) to 0.91 (when the range was the last 15 years)). Consequently, tax advisers are almost unanimously agreed that the fiscal system has become more complex in recent years.

What kind of factors are driving this greater complexity? It is particularly interesting to analyse whether the factors are exogenous to the legislation, such that complexity is an intrinsic feature of today's fiscal systems that has to be borne. Or alternatively, that the factors behind it are endogenous and, therefore, it is legislation that is causing increased complexity. The response to each of these factors is again a dichotomy: Yes (=1) or No (=0). The factors are not mutually exclusive, as increased complexity may come from a combination of the two. The results are shown in Table 2.

By a wide margin, tax advisers consider the origin of the complexity to be endogenous, and almost 100% of respondents consider the main factor to be to continual amendment of the legislation, which, moreover, leads to legal uncertainty. The interpretation of the legislation and the terms in which it is drafted are the two other endogenous factors that over 60% of advisers felt cause greatest complexity, while decentralisation of legislative authority to the autonomous regions was only considered a cause of complexity by 40% of respondents. Moreover, the results clearly indicate that

Tax advisers almost unanimously agree that the Spanish fiscal system is highly complex, mainly as a result of the continuous changes made to the legislation, which also lead to legal uncertainty. The way in which the legislation is drafted and interpreted are two more factors adding to its complexity.

Table 2

Source of greater complexity: Endogenous factors/exogenous factors

Variable	Observ.	Mean	Std. Dev.	Min.	Max.
Endogenous Factors					
Continual changes to the regulations	272	0.982	0.135	0	1
Interpretation of laws by the administration	272	0.684	0.466	0	1
Deficient legislative drafting	272	0.614	0.488	0	1
Attribution of legislative power to the regions	272	0.408	0.492	0	1
Exogenous Factors					
Internationalisation of the economy and mobility of tax bases	272	0.191	0.394	0	1
Growing market complexity	272	0.191	0.394	0	1

Source: Own elaboration.

only a minority of tax advisers (19%) consider complexity to be caused by exogenous factors,such as internationalisation and mobility of tax bases and growing market complexity.

The equity of the Spanish fiscal system

Having ascertained the tax advisers' views on issues related to the efficiency and complexity of the fiscal system, they were also asked how they rated the system from the equity point of view, based on their professional experience. Specifically, the question asked was: *Do you think that those who contribute most are the wealthiest, or the middle and working classes?* Here the question was strictly positive, leaving normative issues to one side –as suggested at the start of this section. The result of the answers was overwhelming: 93.4% considered that the middle and working classes made the biggest contribution, and only 4.4% that the richest did, while 2.2% did not know the answer. As a result, based on this finding, it may be concluded that tax advisers' professional experience teaches them that the fiscal system as a whole is regressive.

To conclude, do they believe the Spanish fiscal system needs reform?

The survey's findings show the Spanish fiscal system to suffer from significant inefficiencies and that it is considered overly complex and unfair. But, looking back to late 2012, did they think the Spanish fiscal system needed reform? Almost 90% of the tax advisers surveyed considered that the Spanish fiscal system did indeed require an overall reform. The estimate by ordinary least squares (see Table 3) does not suggest significant bias resulting from characteristics of respondents or the firms in which they work, although it should be noted that there was a big difference between advisers based in the "foral" communities of Navarre and the Basque Country and those elsewhere in Spain.

Table 3

Analysis of biases in responses on the need for an overall reform of the fiscal system

Variables	Need for reform
Years of experience	0.0066
	(0.041)
Age	0.0011
	(0.003)
Sex	-0.0020
	(0.061)
Educational attainment	-0.0283
	(0.036)
Professional grade	-0.0049
	(0.031)
Size of firm	0.0081
	(0.034)
Average income in region	-0.0411
	(0.056)
Wealthy region	-0.0387
	(0.045)
Foral region	-0.4329***
	(0.094)
Constant	0.9260***
	(0.201)
Observations	272
R2	0.091

Standard errors in brackets

*** p<0.01, ** p<0.05, * p<0.1

Source: Own elaboration.

The 2014 fiscal reform: An assessment based on tax advisers' opinions

The 2014 fiscal reform focused particularly on the personal income tax and the corporate tax, and was enacted through Laws 26/2014 and 27/2014, respectively, on November 27th, 2014.[6]

[6] While it is true that Law 28/2014 was also passed, making changes to the VAT and other indirect taxes, the scope and interest of the reform is much smaller for the purposes of our objective, so the changes introduced will not be discussed here.

Both legislative instruments have introduced tax cuts, and have modified a number of aspects of both how the tax base and liability are calculated, so may therefore have an impact on how the tax burden is distributed and the efficiency of the system. In this section, we will discuss and analyse those changes we consider most significant for these purposes and which relate to the issues raised in the survey of professional tax advisers.

Objective estimation by modules in income tax

Small and medium-sized enterprises can opt to apply the objective estimate arrangements for their personal income tax, based on certain signs, indices and modules, under which they pay a flat rate. Law 26/2014 retains this system, although it significantly reduces its scope of application by making the limits that have been set over time more restrictive. Moreover, the new legislation expressly excludes certain activities that could previously opt for objective estimation.

Specifically, one of the limits derives from the net earnings obtained the previous year. The threshold has been reduced from 450,000 euros to 150,000 euros for the taxpayer's economic activities as a whole.[7] Additionally, contrary to the previous situation, when calculating this amount, all the transactions carried out need to be taken into account, regardless of whether there is the obligation to issue an invoice or not. In any event, a specific lower limit of 75,000 euros is set in the case of transactions for which an invoice is to be given. Another limit envisaged takes into account the volume of purchases of goods and services, excluding fixed assets, in the previous year. In this case, the amount has been reduced significantly, from 300,000 euros to 150,000 euros.

The reform also eliminates the cause of extinction established for other activities.[8] The elimination is justified by the fact that the Thirty-sixth additional provision of Law 26/2014 establishes the exclusion of a large share of these activities from objective estimate arrangements. Specifically, this affects activities related to the rates of the municipal business tax, mainly corresponding to the manufacturing and construction industries. It is also envisaged that the specific amount for other activities not directly excluded be reduced in order to further curtail the application of objective estimation.

Consequently, the new more restrictive limits and the exclusion of certain activities aim to significantly reduce the activities that can use this approach, limiting them mainly, as the preamble to Law 26/2014 states, to activities that entail dealing directly with end consumers.

How can this legislative change be judged based on the survey's findings? As Table 1 shows, a large portion of tax advisers have concluded that

The new legislation reducing the scope of application of the objective estimate arrangements should lead to a fairer and more efficient distribution of the tax burden, and a reduction in tax evasion.

objective estimation by modules facilitates tax evasion in the case of income tax and other taxes. They also strongly agree that the amount estimated on the objective estimate approach is less than would be the case if actual earnings were assessed, which obviously benefits this group of business owners. Finally, professional tax advisers do not believe that eliminating objective estimation would increase fraud. Consequently,

[7] In the case of agricultural and forestry activities, the earnings-based exclusion limit has been cut from 300,000 euros to 250,000 euros.

[8] Specifically, point (e) of Article 31.1.3 of the tax law for certain activities when the net earnings from them in the immediately preceding year collected from parties obliged to make withholdings or advance payments exceeds a certain threshold. This scenario was introduced by Law 7/2012, October 29th, 2012, on the prevention of and the fight against fraud.

based on tax advisers' judgement, the new legislation's restricting the scope of application of objective estimate arrangements may be viewed favourably. It may also be considered that the reduced scope of application of objective estimation will enable a fairer and more efficient distribution of the tax burden, and a reduction in tax evasion. On the other hand, does it imply greater complexity in the application of the tax? Again, based on their professional experience, tax advisers generally agree that objective estimate arrangements are simpler to apply, although the view is not overwhelming.

In short, this measure is in line with that advocated by academia (*e.g.* see the Decalogue for a reform of the fiscal system in Esteller and Durán, 2013, signed by 50 Spanish university lecturers; or Paredes, 2010), although we should still consider whether it would not be more advisable to eliminate objective estimation entirely and replace it by a simplified method that would ensure small business owners paid tax more in line with their real economic capacity. Indeed, the Lagares Report (Comisión de Expertos para la Reforma del Sistema Fiscal Español, 2014) proposes the total elimination of objective estimation. Moreover, it is surprising that the changes to objective estimation described above do not come into force until 2016, except that the intention is to give more time to business owners affected to adapt to the extra formal obligations arising out of taxation by direct assessment.

Tax rates, estimating the tax base and deductions for economic activities in income tax and corporate tax

When analysing the income tax and corporate tax, it is important to look at them both together, as they both affect income and there may, therefore, be a certain transfer of income from one tax to the other.

The tax scale of each tax is the first element to consider, and tends to be the element on which public opinion focuses. In this regard, the reform introduces a cut in the tax rates applied in the case of both taxes. In the case of the income tax, as of 2015, the complementary scale applied since 2012 has lapsed, which entails a reduction in total marginal rates of between 0.75 and 7 percentage points. Additionally, the tax rates on the general state scale will drop by between 1 and 2.5 percentage points in 2016 (0.5 points in 2015), although with the change in the number and width of the brackets (reduced to five), marginal rates may go up for some taxpayers.[9]

In the case of the corporate tax, the general rate has been reduced to 28% in 2015 and 25% from 2016 onwards.[10] This reduction means that as of 2016, the lower rate for small businesses will be eliminated. The preamble to Law 27/2014 justifies this on the grounds that the difference in rate is a "disincentive or obstacle to business growth." The rate of tax that has been in effect for "micro-enterprises" to maintain or create employment will also be eliminated as of 2016. Lastly, reform to corporate tax maintains and expands the reduced rate envisaged for newly created firms established since 2013, such that firms established as of 2015 pay tax at a rate of 15% of total profits in the first two years in which they obtain positive earnings.

Consequently, in terms of nominal tax rates, the difference between the maximum marginal rates of the personal income tax and the general rate of corporate tax has narrowed with the reform. Whereas in 2014, the maximum marginal rate of personal income tax was between 46.9% and 56%, depending on the autonomous region in which the taxpayer lives, in 2015, it is between 44.5% and 49%. By cutting the general corporate tax rate to 28% in 2015, the difference between the two taxes has dropped from 26 percentage points to 21 points in 2015 and 23 points in 2016.[11] With

[9] On top of this reduction, changes in the regional brackets need to be added, depending on the rate each autonomous region sets.

[10] However, the tax rate has been kept at 30% for credit institutions.

[11] The lowest marginal rate is in Madrid and the highest in Catalonia. The comparison for 2016 has been made assuming that the regional rates do not change with respect to 2015.

the fiscal reform, therefore, it seems that the gap between the maximum rate of personal income tax and corporate tax has narrowed somewhat, although a considerable difference remains. However, the reduced rate of 15% envisaged for newly created firms means that when starting a new business or professional activity, the difference in income tax and corporate tax rates is very large, reaching up to 33 percentage points, although this difference will only persist for the first two years of profits.

If we take into account the additional tax burden a shareholder in a company faces in the form of the tax on the dividends received, the result of comparing the nominal tax rates certainly changes. Indeed, elimination of the exemption on the first 1,500 euros of dividend payments in force until 2014 implies the full adoption of the classic approach to taxing dividends. This means that the total taxation as of 2016 will be 42.25%, if we add the upper marginal tax rate of the savings scale of 23% to the corporate tax rate. Consequently, the total value is much closer to the higher marginal income tax rates an individual business owner may have to pay. However, if the company refrains from distributing dividends, the level of taxation will be only that of the corporate tax. The taxpayer can therefore decide when and at what rate he pays income tax on this income.[12]

Income tax has led to company structures being set up to reduce tax charges. Some of the changes introduced by the reform of corporate tax may help avoid this, although the impact of other changes may act in the opposite direction.

Is the difference between the income tax and corporate tax rates significant for tax advisers? As Table 1 shows, the second question that generates the highest degree of agreement among tax advisers (an average value of 3.379) is precisely that personal income tax leads to the creation of company structures in order to reduce tax charges.[13] In any event, when comparing income tax and corporate tax, it is not just nominal tax rates that are relevant, as we also need to take into account differences in the calculation of the respective tax bases and deductions.

In this regard, in the direct assessment of the earnings from economic activities, the personal income tax legislation refers mainly to corporate tax legislation, thus guaranteeing a degree of neutrality.[14] However, certain specific features of simplified assessment should be noted. In particular, tax-deductible depreciation is calculated on a straight-line basis from a simplified depreciation table and there is a reduction of 5% of net earnings for expenses that are difficult to substantiate. With the reform under Law 26/2014, a ceiling of 2,000 euros is imposed on expenses that are difficult to substantiate.[15] The limit will therefore affect taxpayers declaring net earnings of more than 40,000 euros.

[12] From the academic point of view, it would be more appropriate to talk of marginal rates or effective average rates. Nevertheless, nominal rates are also relevant, indeed they are the focus of public debate, so are therefore likely to be those professionals take into account when they are asked if income tax leads to company structures being created.

[13] The academic literature highlights that it is important to avoid the legal form an economic activity takes affecting how it is taxed. For example, De Mooij and Nicodème (2008) observe that between 1997 and 2003 in 17 EU countries there was a transfer of income from personal income tax to corporate tax. Specifically, they estimate that the differences in the rules on the two taxes lead to a transfer to corporate tax accounting for between 10% and 17% of this tax's total tax collection. In the case of Spain, Domínguez *et al.* (2005) find, on the other hand, fiscal factors not to be significant in Spanish firms' organisational decisions, although the authors are cautious about the results in view of the short time period available in their study.

[14] Objective estimation was analysed in the previous section, so will not be discussed again here.

[15] This figure coincides with the fact that the new deduction for other expenditure was introduced with the reform in the calculation of employment income.

In the case of corporate tax, the special arrangements for small businesses have been retained, although some important changes have been made. As of 2016, they will no longer benefit from a lower tax rate, as the general rate is set at 25%. The flexible depreciation provided for small value investments has also been eliminated, as it has been made available to all businesses, as we shall see. Accelerated depreciation for reinvestment of extraordinary income has also been eliminated, in line with the elimination of the similar deduction that until 2014 had been applied to the tax due. And finally, the deduction for investment of profits that small entities have been able to apply for their earnings obtained in the financial years beginning in 2013 and 2014 has also been eliminated.

Therefore, from now on, the special arrangements for small businesses will be limited to flexible depreciation for investments creating jobs, accelerated depreciation of new fixed asset items and impairment of credit for possible insolvencies. As an important new feature, the reform introduces a tax concession that, indirectly, allows tax losses to be offset with profits from past years, similar to the retroactive offsetting of losses in past years, known as loss carryback.

Specifically, the so-called levelling reserve allows a small entity to reduce its positive tax base in a given year by up to 10%, up to a maximum of a million euros. This negative adjustment must be reversed in the following five years provided the company has a negative tax base. In other words, it is possible to offset losses incurred in the five following years. If insufficient losses have been incurred in this period, the remaining amount must be added to the tax base in the last year of the period. The company is required to constitute a non-available reserve for the amount of the reduction to the tax base. This non-availability ceases when the adjustment is backed out, *i.e.* within five years.

Consequently the new reserve allows the taxation in a tax period to be reduced against the losses incurred in the subsequent five years, thus bringing forward the application of future negative tax bases. If these losses are not incurred during the five year period, the adjustment is reversed in the fifth year, such that finally a deferral of taxation on the reserve has been obtained.

As a result, the new corporate tax retains the special arrangements for small entities, which in practice means they can defer a portion of the tax. These arrangements are also applicable to business owners who are subject to direct assessment for personal income tax, with the exception of the levelling reserve, which of its nature, does not apply to natural persons conducting a business activity.

In short, corporate tax includes special treatments that may influence the choice of company legal structure. On this point, when tax advisers were asked if the tax influences decisions on the legal structure of companies, we obtained a relatively high degree of agreement, with 2.923. Eliminating the reduced rate and reinvestment deductions for small businesses could help make the tax more efficient, but in turn, the general application of a reduced rate for new entities, together with the maintenance and creation, in the case of the levelling reserve, of certain tax benefits seems to go in the opposite direction.

The treatment of debt and equity in the corporate tax

In most countries, the corporate tax allows interest on debt to be deducted, whereas the opportunity cost of equity is not deductible. This bias in favour of debt has been given more attention in the wake of the recent crisis. Thus, empirical studies (*e.g.* Slemrod, 2009; Keen et al., 2010) show that this distortion, while not being the main cause of the financial crisis, has nevertheless contributed to its spread.

In response, countries such as Germany, France, the United Kingdom, and Spain since 2012, have introduced limits on the deductibility of debt. Specifically, in the Spanish case, net financial expenses are fully deductible up to a million euros, with a limit of 30% of operating profit over this threshold. Financial expenses arising on transactions within a business group have also been made non-deductible, unless these transactions are reasonable from an economic viewpoint. However, the intended purpose of these limitations has not been to ensure neutrality between debt and equity financing, but to combat international tax planning by multinationals.

A significant new feature introduced by Law 27/2014 was a capitalisation reserve with the aim, as expressed in the preamble, of "having an impact on the neutrality of how business finance is raised, stabilising a balance that has for a long time been inclined in favour of debt." Specifically, companies can apply a reduction in their tax base of 10% of the increase in equity during the financial year, up to a limit of 10% of the tax base. If this limit is exceeded, the pending reduction can be used in the tax periods ending in the two following years. In order to apply this reduction, the increase in equity must be maintained over five years and a reserve, which is to be unavailable for the period, set aside for the value of the reduction. Consequently, as of 2015 entities that increase their equity benefit from a tax incentive equal to 10% of the increase, which will certainly improve the neutrality of the tax for companies' financial decisions. This incentive, combined with the retention of the limits on the deduction of financial expenses, reduces the traditional asymmetry between debt and equity financing.

Do tax advisers believe that corporate tax's asymmetry influences the way in which companies are financed? The survey suggests that they take a somewhat sceptical view, with an average value of 2.426. Therefore, they do not consider corporate tax to be the most important factor when deciding how to raise finance, or at least not universally. To conclude, although the change introduced in 2015 should be viewed favourably insofar as it reduces the bias in favour of debt, tax advisers' view is that financing decisions depend at the margin on factors unrelated to tax treatment, such as access to credit, investment opportunities or expected returns.

For tax advisers, corporate taxation has not been the most important factor in choosing between debt and equity finance, which is more dependent on other factors. However, the changes introduced in 2015 should be viewed positively as they reduce the fiscal bias towards debt.

Neutrality in investment decisions

Depreciation reflects the deterioration suffered by capital goods over time as a result of their operation, use and obsolescence. From the theoretical point of view, when calculating economic profit, the real deterioration of capital goods should be deductible. Nevertheless, in practice, when calculating the tax base, effective depreciation is calculated using officially approved depreciation tables, in order to simplify tax compliance. Specifically, the implementing regulations for corporate tax, Royal Decree 1777/2004, of July 30th, 2004, set out the official depreciation tables in an annex following the National Classification of Economic Activities´ (CNAE) structure. That means setting the maximum coefficient and maximum depreciation period for more than 650 depreciable items.

The tax reform introduced a significant new feature, as the coefficients and maximum depreciation period are now regulated by Law 27/2014, Article 12, and the number of items has been considerably reduced, with just 33 now regulated. This is a clear example of a trade-off between efficiency and simplicity. As they regulated so many depreciable items, the tables applied previously took sector specificities into account better, such that depreciation could be kept closer to its effective rate. However, as explained in the preamble to the law, the legislator considers it important to “simplify the depreciation tables, reduce their complexity, and provide more up-to-date tables that can be better applied in practice.”

As regards depreciation, the new legislation also introduces the new feature of flexible depreciation of low value goods, the precedent for this being the arrangements that existed for small entities, which, as mentioned above, have now been eliminated. Specifically, there is freedom over the depreciation of new fixed assets worth under 300 euros, up to a maximum of 25,000 euros. Although this change is not mentioned in the preamble, it clearly also aims to be a simplification, as the low value of the items concerned makes the administrative cost of calculating their annual depreciation somewhat unreasonable.

Does the corporate tax influence decisions about the types of investments to make? Tax advisers' opinions are somewhat contrary on this point, suggesting that the changes made by the new legislation are unlikely to have much impact on decisions of this kind, and it therefore looks positive that priority has been given to simplicity over efficiency.

The neutrality of assets in which to hold savings

The Spanish personal income tax enacted by Law 35/2006 represented a significant change in the income tax model by explicitly introducing a dual rate, whereby a substantial share of income from savings forms a separate tax base that is taxed at lower tax rates. The purpose alluded to in the preamble to the law was to give “neutral treatment to income from savings, eliminating the unjustified differences that currently exist between the instruments in which they are held,” as well as improving “Spain's position in the international context of free movement of capital and strong competition.” However, Law 35/2006 did not introduce absolute neutrality, insofar as other investment income is not included in the savings tax base (*e.g.* income from real estate and earnings from economic activities arising from the capital allocated to them), nor does it eliminate the special treatment that for various reasons the law establishes in favour of certain assets (*e.g.* tax credit for the purchase of a main residence or the reduction in the tax base for contributions to pension schemes).

Subsequently, the deduction for taxpayers' investments in their home ceased to apply as of 2013, although on a transitional basis, it remains in effect for all taxpayers purchasing their home before that time. The new individual income tax law maintains these transitional arrangements. What is new is the elimination of the tax credit for renting of the main residence, which had been introduced in 2008, under similar terms to the deduction for purchase, although conditional upon taxpayers' income levels. The reform therefore unifies the tax treatment of main residences that are rented or owned.[16]

As Table 1 shows, tax advisers strongly agree that personal income tax has encouraged taxpayers to purchase their homes rather than rent them. The average value of the replies is 3.051. The elimination of the deduction for rent may certainly improve the neutrality of the tax as regards taxpayers' decisions to buy or rent their home, but it is worth noting that other significant features of the law on personal income tax and other taxes continue to offer highly favourable tax treatment of home purchases. The non-imputation of income for use of the main residence and exemption of possible capital gains on the sale of the main residence by taxpayers aged over 65 are two clear examples of aspects of personal income tax that favour home purchasing. Likewise, the exemption of the main residence from wealth tax and the reduction provided by gifts and inheritance tax are

[16] On a transitional basis it also allows application to leases entered into before 2015.

two major examples of tax advantages favouring home purchase, contrary to the supposed neutrality vis-à-vis renting.

In relation to savings, however, the new tax reform introduces other significant changes such as the favourable treatment given to long-term savings plans (PALP in their Spanish initials). In order to encourage long-term saving, the new rules allow taxpayers to pay up to 5,000 euros a year into individual long-term life-insurance policies or long-term individual savings accounts. The yields produced by these savings mechanisms are exempt provided the taxpayer receives them as capital and five years have passed since the payment was made into the policy or account. The aim here is basically to encourage savings by small investors.

In this regard, another noteworthy change is that all capital losses and gains are incorporated in the tax base, regardless of the period over which they accrued. This had been the case since the introduction of the current tax in 2007, but during 2013 and 2014 they were included in the general tax base when the accrual period was less than a year.

What is tax advisers' opinion about the neutrality of the personal income tax regarding the types of assets in which people invest? The average value of the answers, 2.312, shows a certain degree of agreement that the tax is not neutral with regard to savings, although the opinion is not so clear cut as in the case of homes. The new PALPs imply favourable tax treatment for a certain type of saving by means of a tax concession, namely the exemption of their earnings, with the aim of fostering long-term saving, although this means distorting tax neutrality.

Conclusions

This article set out to assess the content of the tax reform passed in late 2014. To perform this assessment, we have described the most important legal changes, specifically those affecting the income tax and corporate tax. The assessment has drawn on the results of a survey of professional tax advisers. Their responses should be viewed as a first-hand check on the shortcomings of Spain's fiscal system, focusing on aspects, such as efficiency, tax planning, equity and complexity. We believe this type of analysis helps ascertaining the real view that the tax consultancy world has of our fiscal system.

The recent reform of income tax and corporate tax is headed in the right direction in that it removes distortions and mitigates tax planning, as well as reduces complexity. The assessment of the cut in marginal rates, on the other hand, is a matter of individual preferences.

Based on our review of the changes and tax advisers' opinions, we believe that the reform is headed in the right direction in terms of eliminating distortions and mitigating tax planning *(e.g.* the treatment of debt and equity in the corporate tax, limiting the application of objective estimation by modules in personal income tax, or eliminating the distinction between long- and short-term capital gains), and reducing complexity (e.g. depreciation in the corporate tax), and therefore, certain trade-offs have been achieved. Any possible assessment of the cuts in marginal rates –leaving efficiency issues to one side– is a subjective matter. Finally, we note that it would be desirable –as the survey findings also suggest– to avoid legislative hyperactivity and that the results of this reform underpin the start of the Spanish economy's recovery and greater stability in our fiscal system.

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