The Inward Investment and International Taxation Review

Fourth Edition

Editor
Tim Sanders

Law Business Research

The Inward Investment and International Taxation Review

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EDITOR'S PREFACE

The taxation of cross-border corporate structures is highly topical. Companies such as Starbucks, Google and Amazon have become the centre of a great deal of unwanted attention. Governments faced with depressed economies and falling tax revenues have turned their attention to what they perceive as a growing trend for multinational companies to push their activities into low- or no-tax jurisdictions. This perception led to the G20 asking the OECD to create an action plan that culminated in July 2013 with the publication of the OECD Action Plan on Base Erosion and Profit Sharing (the Report). The Report acknowledges the increase in cross-border trade, facilitated by factors such as the removal of trade barriers and the use of technology, which make it ever easier for businesses to locate production far from the jurisdictions in which their customers are located. The Report identifies the fact that the trend is influenced by tax considerations, the more aggressive aspects of which are clearly going to come under increasing scrutiny. The Report identifies the need to tighten rules on transfer pricing, to end or neutralise tax arbitrage arrangements, and to prevent companies artificially avoiding establishing permanent establishments, and also identifies areas for action, such as increasing disclosure requirements. In all, the Report identifies 15 areas that are likely to dramatically change the tax landscape for companies and businesses operating in the global economy.

Despite this backdrop of uncertainty and the threat of increasingly complex rules with penalties for those companies that move jobs and economic activity elsewhere in a manner deemed unacceptable, companies will continue to trade in the global economy and across borders. This requires, more than ever before, not only detailed evaluation and comparison of the tax benefits and incentives available in competing jurisdictions, but also consideration of the tax consequences of moving capital and income flows across international borders. Consideration of such cross-border tax opportunities, issues and conflicts between tax systems requires business tax advisers to be increasingly aware of tax laws beyond the geographical boundaries of the country in which they practise.

The aim of this book is to provide a starting point for readers, and to assist businesses and advisers, each chapter providing topical and current insights from leading experts on

the tax issues and opportunities in their respective jurisdictions (and, in one chapter, within the European Union). While specific tax advice is always essential, it is also necessary to have a broad understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I should like to thank the contributors to this book for their time and efforts, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors and not of their firms, the editor or the publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

Tim Sanders
Skadden, Arps, Slate, Meagher & Flom LLP
London
January 2014

Chapter 35

SPAIN

José Gabriel Martínez Paños[1]

I INTRODUCTION

As is the case in most European countries, Spain has faced significant economic and social challenges in recent years as a result of the global financial and debt crisis.

To overcome this situation, Spain's government was forced to implement many aggressive and unpopular measures, focused on three lines of action:

a a thorough and long-awaited reform of the labour market to introduce flexibility, reduce labour costs and gain competitiveness;

b a crucial reform of the Spanish banking sector to ensure the solvency of the financial institutions, consolidate the sector and mitigate fears regarding Spanish banks' exposure to real estate; and

c implementing measures to reduce the public deficit and achieve the target levels agreed with the EU.

This final objective brought drastic cuts in public spending as well as tax increases (in particular, personal income tax and VAT rates as well as certain restrictions on deductible expenses for corporate income tax purposes) to raise public revenues.

These measures were received favourably by the EU and international financial organisations, reduced pressure in international markets in connection with Spanish debt and, finally, seem to be yielding benefits: exports have grown exponentially (due to the gain of competitiveness of the Spanish economy because of the reduction of labour costs); unemployment has been stabilised; domestic consumption levels are improving slightly, and, as a consequence, Spain has already emerged from its recession.

In summary, although Spain does not yet find itself in an ideal situation from an economic perspective, the economic expectations for the coming year are more positive

1 At the time of writing José Gabriel Martínez Paños was a senior associate at Uría Menéndez.

than they have been since 2007, and investors can therefore be optimistic about the future of the country as a potential target for investment.

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

Spanish law regulates legal entities, generally referred to as 'companies'. They have legal personality and can acquire rights and assets, and assume liabilities. Companies are mainly governed by the Commercial Code and the Spanish Capital Companies Law. Companies are subject to corporate income tax (CIT).

In addition, there are other legal forms of business without legal personality used for special purposes. The most common are the 'temporary consortia' (UTEs). UTEs are often used in public construction projects, and usually allocate their taxable income to their members, although different rules may apply when the members are not resident in Spain.

i Corporate

The main types of companies in Spain are public limited companies (SAs) and private limited companies (SLs).

In the past, SAs were the most widely used legal vehicle to set up a company in Spain. However, SLs have become more popular recently due to their flexibility in terms of organisation and management. SAs limit the liability of shareholders to amounts contributed to the equity of the company. This participation is represented by shares that qualify as negotiable securities. Furthermore, shares in an SA may be listed on the Spanish stock exchanges. The minimum capital to set up an SA is €60,000, which must be fully subscribed and at least 25 per cent paid up upon incorporation.

SLs have traditionally been used in Spain as an investment vehicle for small, family-run businesses. However, SLs have become the most common type of business entity for non-listed companies, due to their flexibility. The partners' liability is limited to their investment in the company's equity. The capital of an SL is represented by 'quotas', an instrument that closely resembles the shares of an SA. However, quotas are not represented by certificates and may not be listed on stock exchanges. The minimum capital required for an SL is €3,000, which must be subscribed and paid up in full upon incorporation.

ii Non-corporate

There are three main types of partnerships in Spain:

a general partnerships (SCs), private entities with legal personality and unlimited joint liability, governed by the Commercial Code;

b simple limited partnerships (SCSs); and

c limited shareholder partnerships (SCAs), both of which have legal personality and two types of partners: general partners, with unlimited liability, and limited partners, with liability limited to their contribution.

These three types of partnerships are subject to Spanish CIT on their income similarly to a Spanish company.

There are other types of business organisations in Spain, such as UTEs, joint ownership, joint account contracts and civil law partnerships. The majority of these associations do not have separate legal personality to that of their members, and in most cases they allocate their taxable income to their members. The fact that these vehicles are fiscally transparent and have unlimited liability make them generally unattractive and, except in some cases (e.g., UTEs), they are not widely used by investors.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

The taxable income for CIT purposes is based on the accounting result, calculated in accordance with the Spanish GAAP,[2] although adjusted in accordance with the CIT Law.

This means that, in general, worldwide income is taxed on an accrual basis. Business expenses are deductible as long as they are properly recorded in the taxpayer's books and are not classified as 'non-deductible' by the CIT Law.

All fixed assets, excluding land, may be depreciated for tax purposes. Official guidelines establish maximum annual rates and maximum periods of depreciation, calculated on the basis of the useful life of the asset.

Capital and income

Capital gains obtained by a Spanish company are generally subject to CIT as ordinary income at the general 30 per cent rate, although certain exemptions and tax credits may be available. For instance, there is a 12 per cent tax credit for reinvestment of extraordinary profits, tax credits for the avoidance of double taxation, and a participation exemption regime applicable to foreign-source dividends and capital gains.

Losses

Losses can be carried forward for the following 18 years after the losses were generated, although certain anti-abuse provisions in the case of intra-group changes in ownership may apply. Loss carry-backs are not allowed.

Rates

The general CIT rate is 30 per cent; however, certain credit institutions and insurance companies are subject to a reduced 25 per cent rate, while some collective investment institutions are subject to a 1 per cent rate. Likewise, certain pension funds are taxed at a zero per cent rate, whereas certain oil companies are taxed at 35 per cent. Companies with a turnover in the previous year below €10 million can apply a reduced tax rate of 25 per cent (or even 15 per cent under certain conditions) for the first €300,000 of taxable income.

2 The Spanish Accounting Chart is based on the IFRS rules, as adopted by the EU.

Administration

The fiscal year for CIT purposes coincides with the financial year of the Spanish company, which may differ from the calendar year. CIT returns must be filed during the first 25 calendar days following the six-month period after the end of the relevant fiscal year. For instance, if the fiscal year ends on 31 December, the CIT return would have to be filed during the first 25 days of July of the following year. In addition, Spanish companies have to make payments on account of their final CIT liability in the first 20 days of April, October and December.

As regards tax administration, the majority of Spanish taxes are imposed by the Spanish State Tax Authority, although certain taxes are levied by the autonomous regions and the municipalities. Thus, in general, the Spanish State Tax Authority is in charge of ensuring that Spanish companies comply with their tax obligations. However, certain taxes (e.g., capital tax or transfer tax (TT)) are collected by the tax officers of the different autonomous regions.

Audits on Spanish companies are carried out in accordance with the general directives set out in the audit plan approved by the Spanish government annually. These directives will depend on the specific goals to be achieved and business sectors that the government decides to focus on each year.

Spanish companies may obtain rulings from the Spanish tax authorities confirming the tax treatment and tax consequences of a particular transaction (see Section IX.iv, *infra*).

Finally, in the event of a discrepancy with a tax assessment issued by the Spanish tax authorities, Spanish companies may challenge it by filing appeals before the tax authorities and, subsequently, before the Spanish courts.

Tax grouping

Group companies can choose to be taxed under the special tax consolidation regime set out in the Spanish CIT Law. In principle, only Spanish resident entities may form part of a tax-consolidated group, although permanent establishments (PEs) in Spain of non-Spanish entities are allowed to head a Spanish tax-consolidated group.

The parent company, or PE, must directly or indirectly hold at least 75 per cent of the share capital of its subsidiaries (70 per cent if the subsidiaries are listed on a regulated stock exchange) on the first day of the fiscal period in which the tax regime is to be applied. This stake must be maintained throughout the entire fiscal period.

Consolidated taxable income is determined by totalling:

a the taxable income of each group company;

b profits and loss eliminations derived from intra-group transactions;

c re-inclusions of eliminations carried out in previous years when they are realised with regard to third parties or if the company involved in the eliminated intra-group transaction leaves the group; and

d offsetting the negative taxable income when the aggregate of (a), (b) and (c) is positive.

Tax losses obtained by a group in a tax period can be carried forward and offset against taxable income obtained by the group in tax periods ending in the following 18 years. Group companies lose the right to offset tax losses individually if they have consolidated

taxation status. However, tax losses incurred prior to joining the tax group can be carried forward against group taxable income within the 18 years following the end of the loss-originating period limited to the taxable profit made by the company that generated the losses to be carried forward.

ii Other relevant taxes

Value added tax

The structure and scope of the Spanish VAT system are similar to those applicable in other EU countries and follow the EU VAT Directives.

As a general rule, VAT is levied on transfers of goods made or services provided by entrepreneurs, on certain intra-EU acquisitions and on the importation of goods.

Taxpayers charging VAT on their transactions are entitled to deduct the tax borne within a taxable period (input VAT) from the tax collected (output VAT) within the same period. Any excess of output VAT must be paid to the tax authorities, and any excess of input VAT can either be set off against future output VAT, or a refund can be requested.

The standard VAT rate is 21 per cent, although reduced rates (10 and 4 per cent) may apply depending on the type of goods delivered or services rendered.

Transfer and provision of certain goods and services, such as certain transfers of real estate, financial transactions or the transfer of securities, are exempt from VAT.

Transfer tax

TT is levied on the transfer of rights and assets located in Spain, as well as on the creation of security interests and other rights *in rem*, provided that such transactions are not subject to VAT (this means that, generally, TT applies when the transaction is carried out by an individual, while VAT applies when the transaction is carried out by an entrepreneur). TT on the transfer of real estate is levied at different rates depending on the autonomous region where the real estate is located (generally, a 7 per cent rate is levied on the value of the real estate). Pursuant to an anti-abuse provision, under certain conditions, the transfer of shares of real estate companies may also be subject to TT, which is payable by the acquirer of the assets and is not recoverable.

Capital tax

Incorporation, capital increases and share premium contributions to Spanish companies are exempt from capital tax in Spain.

Stamp duty

The granting of public deeds in Spain, the issuing of bills of credit, promissory notes and other documents involving transfers of funds, and the issuing of certain administrative documents may be subject to stamp duty.

Payroll taxes

Spanish companies must apply a withholding tax on account of their employees' personal income tax. Spanish labour regulations provide that Spanish companies must make

contributions to the Spanish social security system. The contributions are calculated based on the employees' monthly salary plus any amounts paid on an annual basis.

IV TAX RESIDENCE AND FISCAL DOMICILE

i Corporate residence

A company will be tax resident in Spain if:

a the company has been incorporated in accordance with Spanish law;
b its corporate residence is in Spain; or
c its seat of management is in Spain.

Therefore, a company incorporated outside Spain will not be tax-resident in Spain unless it is managed and controlled in the Spanish territory.

ii Branch or permanent establishment

Pursuant to the OECD guidelines, under the Spanish tax treaty network (and under domestic legislation), a non-resident entity will be deemed to have a PE in Spain if it has a fixed place of business in Spain through that the non-resident entity conducts business activities; or there is a person or entity (other than an independent agent) acting in Spain on behalf of the non-resident entity, provided that such person or entity has, and usually exercises, authority to conclude contracts on behalf of the non-resident entity in Spain.

A PE will be subject to tax in Spain in almost the same conditions as a Spanish company subject to the Spanish CIT. Accordingly, any profits allocated to the PE will be taxed at the general CIT rate. The taxable income of the PE will be determined in accordance with the provisions of the CIT Law, although certain minor exceptions may apply.

Profits transferred by a PE to its head office will be subject to a 21 per cent branch tax. Spanish branch tax will generally not apply if the head office is resident either in an EU country not classified as a tax haven, or in a country that has entered into a convention for the avoidance of double taxation with Spain.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

i Holding company regimes

The CIT Law provides a special tax regime for Spanish holding companies (ETVEs). A participation exemption regime applies to dividends and capital gains obtained by ETVEs from their active foreign subsidiaries, provided that certain requirements are met: a 5 per cent minimum stake in the subsidiary, a one-year minimum holding period, the subsidiary must pass a 'subject-to-tax' test and the subsidiary must obtain mainly active (i.e., not tainted) income.

Furthermore, the distribution of dividends by an ETVE to its non-resident shareholders (not resident in a tax haven) will not be subject to Spanish withholding tax, and capital gains triggered by the non-resident shareholder (not resident in a tax

haven) on the transfer of its shares in the ETVE will not be subject to Spanish tax to the extent that such capital gains (indirectly) arise from an increase in value of the foreign subsidiaries of the ETVE.

ii IP regimes

Income from IP assets is treated as regular taxable income for CIT purposes. However, under certain conditions, the CIT Law provides a 60 per cent tax credit applicable on taxable income derived from the assignment of the right to use certain IP assets (e.g., patents, drawings, models, secret procedures, rights over information on industrial, commercial or scientific experience) and from the sale of those IP assets.

iii State aid

In the past, the Spanish authorities have provided financial aid and tax benefits for activities carried out in certain industry sectors that were considered priority sectors (e.g., activities in the agro-food industry, energy, mining, technological improvement, research and development). Due, however, to the current economic climate, benefits and aid have been reduced or in many cases eliminated in order to lower the public deficit and meet EU economic convergence objectives.

iv General

The general CIT rate (30 per cent) in Spain is high compared to the rates applicable in other EU jurisdictions. However, the CIT Law provides a number of tax credits that, when applied by taxpayers, reduce the effective taxation to a level similar to that existing in other comparable countries. Additionally, the fact that the general Spanish VAT rate is equal to the average rate applicable within the EU makes Spain an attractive location to buy or run a business.

As regards international tax planning, the special tax regime of ETVEs and the large Spanish double taxation treaty (DTT) network make Spain a very efficient platform to channel investments in many jurisdictions, especially in Latin American countries.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding outward-bound payments (domestic law)

Dividends, interest and royalties paid by a Spanish company to a non-resident entity are subject to withholding tax in Spain at a 21 per cent (for dividends and interest) and 24.75 per cent (for royalties) rate, or at the reduced rate set forth in the applicable DTT, if any.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Under the EU Parent-Subsidiary Directive, as implemented by Spain, dividends paid to a company resident in the EU and holding a stake in a Spanish company of at least 5 per cent are exempt from withholding tax when such stake has been held for more than one

year. This exemption is rejected if the stake is, directly or indirectly, ultimately controlled by a non-EU individual or entity, unless the EU parent company evidences active management of the stake or similar activities to those run by the Spanish subsidiary.

Interest paid to an EU entity (or a PE of an EU entity in an EU country other than Spain) will not be subject to withholding tax, provided that the EU entity does not act through a tax haven country.

The withholding tax rate on royalties by a Spanish entity to an EU company may be reduced to zero if the requirements set out in the EU Interests and Royalties Directive, as implemented by Spain, are met.

Other exemptions on payments to non-resident entities may apply in accordance with the domestic legislation.

iii Double taxation treaties

Currently, Spain has entered into DTTs with a number of countries.[3] An updated list of the DTTs entered into by Spain, together with the corresponding texts, may be found online.[4]

iv Taxation on receipt

Dividends and capital gains derived by a Spanish shareholder from a non-resident subsidiary will be subject to CIT at the general rate. However, a participation exemption regime or, alternatively, a tax credit for the avoidance of double taxation, may apply.

The participation exemption regime will apply on dividends and capital gains derived from non-resident subsidiaries, provided that:

a the Spanish company holds a minimum 5 per cent interest in the equity of the foreign subsidiary;

b the Spanish company has, directly or indirectly, held such interest for at least one year;

c the foreign subsidiary is subject to and not exempt from a tax similar to the Spanish CIT (this requirement will be deemed met if the foreign subsidiary resides in a tax treaty country with an exchange of information clause) and it is not resident in a tax haven (unless the tax haven is within the EU, the subsidiary

3 Albania, Algeria, Armenia, Australia, Austria, Barbados, Belgium, Bolivia, Bosnia- Herzegovina, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cuba, the Czech Republic, East Timor, Ecuador, Egypt, El Salvador, Estonia, Finland, France, Georgia, Germany, Greece, Hong Kong, Hungary, Iceland, India, Indonesia, Iran, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Korea, Kuwait, Latvia, Lithuania, Luxembourg, Macedonia, Malaysia, Malta, Mexico, Moldova, Morocco, the Netherlands, New Zealand, Norway, Panama, Pakistan, the Philippines, Poland, Portugal, Romania, Russia, Slovakia, Slovenia, the former Soviet Socialist Republics, Saudi Arabia, Serbia, Singapore, South Africa, Sweden, Switzerland, Thailand, Trinidad and Tobago, Tunisia, Turkey, the United Arab Emirates, the United Kingdom, the United States, Uruguay, Venezuela and Vietnam.

4 See www.meh.es.

has been incorporated for valid economic reasons and is engaged in an active trade or business); and

d the foreign subsidiary is engaged in an active trade or business outside Spain.

Should the participation exemption regime not be applicable, the Spanish shareholder will be entitled to a tax credit on the CIT payable on the foreign-source dividend equivalent to the underlying income tax paid by the foreign subsidiary (and any lower tier subsidiary) on the dividends distributed to the Spanish shareholder. The tax credit may not exceed the CIT that would have been payable on Spanish-source dividends. The tax credit will only be available if the Spanish shareholder holds a minimum 5 per cent interest in the equity of the foreign subsidiary and to the extent that it has held such interest for at least one year or, alternatively, the one year holding requirement is met after the dividend has been received (the same requirements will apply with respect to lower tier subsidiaries, if the tax credit relates to income tax paid by the latter).

Additionally, any foreign withholding taxes on the dividends (or any other type of income obtained by the Spanish entity) will be creditable against the CIT, again limited to the CIT that would have been payable on that income if it came from a Spanish source.

VII TAXATION OF FUNDING STRUCTURES

Equity contributions allow for the profits of the Spanish company to be distributed to the shareholders as a dividend, frequently with a reduced or exempt withholding tax. In addition, the shareholder will most likely enjoy an exemption or full credit mechanism that will eliminate any additional taxation on the dividend received.

Investment through debt financing reduces the level of taxable income payable by the Spanish company (interest payments, unlike dividend distributions, are generally tax deductible). However, interest payments are usually subject to a high-interest withholding rate and other limitations could apply (e.g., limitation on the tax deductibility of financing expenses).

Finally, hybrid instruments (e.g., profit participation loans) may be used. They are usually treated as debt for tax purposes, but they are deemed to be equity for certain corporate purposes.

Usually, a compromise is sought between capital and debt financing, although the elimination of the capital tax on equity contributions on 3 December 2010 lead investors to finance their investments in Spain with more equity.

i General restrictions on the tax deductibility of financing expenses

In March 2012, the government replaced the thin capitalisation rules (which scope was substantially reduced as it did not apply to debts with residents in the EU) with a general restriction on the deduction of financing expenses: net financing expenses exceeding 30 per cent of a company's operating profit for a given tax year are not deductible for CIT purposes. In practice, this general restriction operates as a rule on the specific temporary allocation of financing expenses, which can then be deducted in future tax periods in a

manner similar to the offsetting of carry-forward losses. However, net-financing expenses not exceeding €1 million per year will be tax-deductible in any case.

ii Restrictions on payments

Other than the applicable corporate law restrictions (e.g., mandatory legal reserve), there are no restrictions in Spain, under tax or other laws, which prevent the payment of dividends by a Spanish company.

Additionally, Spanish companies may pay interim dividends (i.e., dividends on account of the results that are estimated to be obtained at the end of the fiscal year).

iii Return of capital

Equity capital can be repaid by means of a reduction of share capital. In principle, the capital reimbursed will decrease the tax basis of the stake of the shareholder and will not be subject to Spanish tax unless the amount received by the shareholder exceeds the tax basis of its stake in the Spanish company.

Capital reductions, however, are subject to a 1 per cent capital tax.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Generally speaking, it is worthwhile to use a Spanish entity to channel the acquisition of a business in Spain, because it allows the non-resident investor to take advantage of the Spanish tax consolidation regime or the tax-neutrality regime for corporate reorganisation transactions, in order to improve the tax efficiency of the acquisition (debt push-down structures, etc.), limit the liability of investors, etc.

If they are not conducted through a local entity, acquisitions through EU entities would generally be more efficient from a tax point of view, as they allow investors to take advantage of the benefits set forth in the EU Directives. Special care, however, must be taken when using foreign transparent entities, given that the Spanish tax authorities will look through them to identify the ultimate investors. The use of tax havens should be avoided because they are heavily penalised under Spanish tax laws.

As regards financing structures, please see Section VII, *supra*.

ii Reorganisation

Spain implemented the provisions of the EU Merger Directive in the CIT Law, and extended the tax rules for corporate restructuring transactions contained in the Merger Directive (mergers, spin-off, share exchanges, etc.) not just to those carried out by EU residents, but also to those taking place in the domestic arena and those involving companies in non-EU countries.

The objective of the Merger Directive and of the special tax regime contained in the CIT Law is to eliminate any tax issues that may be an obstacle to corporate restructuring transactions, which are regarded as necessary and beneficial for the domestic and EU economy. The technique used to achieve this objective consists of deferring the

tax due on capital gains that arise in connection with the restructuring transaction at both company and shareholder level.

To be entitled to the benefits of the special tax-neutrality regime, certain formal requirements must be complied with (e.g., express reference to the application of the neutrality regime in the transaction's corporate documents and notifications to the Spanish tax authorities). In addition, the corporate restructuring transaction must be carried out for valid economic reasons and not only to obtain a tax advantage.

iii Exit

The relocation of a company outside Spain can be accomplished without having to carry out the dissolution and liquidation of the company, and subsequently incorporating the new company in the new location. In particular, such relocation could be achieved by migrating the corporate domicile of the company to the new location or changing the effective place of management of the company to the new location. However, unless the new corporate domicile or place of effective management is located in an EU country, these alternatives will give rise to taxation in Spain (exit tax) for the difference between the book value and fair market value of the assets owned by the Spanish company that is being relocated.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

Article 15 of the Spanish General Tax Law allows the Spanish tax authorities to enforce tax liability after applying the rules relating to the acts and agreements, when the taxable event is totally or partially avoided, or the tax base or tax liability is reduced by carrying out certain acts or executing agreements that:

a individually considered, or taken as a whole, are obviously deceitful or inappropriate to obtain the result achieved; and

b have no further legal or economic effects other than the tax savings, and those effects corresponding to the usual or appropriate acts or agreements.

Under Article 16 of the Spanish General Tax Law, the Spanish tax authorities may also act against 'simulated' transactions.

ii Controlled foreign corporations

Spanish companies are subject to controlled foreign corporation rules. Under these rules, certain income generated by a foreign entity in which the Spanish company holds a minimum 50 per cent stake qualifies as taxable income of the Spanish company if, in addition, such income:

a qualifies as tainted income (e.g., financial income or passive real estate income); and

b is subject to tax below 75 per cent of the Spanish CIT that would have been payable.

The Spanish company is not required to recognise tainted income obtained by its EU affiliates as long as it proves before the Spanish tax authorities that the incorporation and operation of the EU affiliate are carried out for sound economic reasons, and that the EU affiliate is engaged in an active trade or business.

iii Transfer pricing

Spanish companies are obliged to assess transactions with related parties on an arm's-length basis.

To determine the fair market value of the transaction, and following the OECD guidelines, the CIT Law sets forth that the parties can use any of the following methods: the comparable uncontrolled price method, the cost plus method, the resale price method, the profit split method or the transactional net margin method (the first three being preferential in use). In addition, the parties will have to produce and keep appropriate documentation in order to evidence the valuation used, if the Spanish tax authorities request it. Non-compliance with this obligation may give rise to tax penalties for the Spanish company.

In order to resolve in advance potential transfer pricing issues, the CIT Law provides for the possibility of submitting to the authorities a preliminary proposed valuation of transactions between related parties (advance pricing agreements).

iv Tax clearances and rulings

Taxpayers may obtain rulings from the Spanish tax authorities confirming the tax treatment and tax consequences of a specific transaction. The ruling requests must be submitted to the General Directorate of Tax, the public body that issues the rulings.

The ruling request must contain all the details of the transaction and of the parties involved, and the particular issues on which the taxpayer needs clarification from the authorities. The authorities have a six-month term to answer a ruling request. The lack of compliance with this term, however, will not be deemed to be a confirmation of the taxpayer's view as regards the tax consequences of a particular transaction.

Rulings issued by the tax authorities are binding upon them. In other words, all the bodies within the Spanish tax authorities (tax auditors, administrative tax courts, etc.) are bound by the content of the ruling and must respect the tax treatment contained in the ruling, provided that there has not been any change in any relevant facts of the transaction, the applicable law or the case law for similar cases issued by the Spanish courts.

X YEAR IN REVIEW

During the past few years, there have been a significant number of changes and developments in the Spanish tax and accounting legislation, with the underlying impetus of boosting public revenue in order to reduce the public deficit and comply with the EU fiscal consolidation policies.

Those measures included increases of the personal income tax and VAT rates, changes in CIT legislation to restrict tax credits and deductions, and a voluntary

disclosure programme for undeclared assets and goods (akin to a 'tax amnesty') with 30 November 2012 as a deadline.

This trend has continued through fiscal year 2013, and new taxes in specific fields have been created (e.g., on tax deposits). There is a general consensus, however, that the Spanish tax system is obsolete and that a substantial reform is needed. That reform would be aimed at simplifying and revitalising the system, with the ultimate goal of increasing taxable bases (with the invariable limit of the mandatory tax progressivity of the system). The Spanish government has already appointed a committee of scholars and technicians to analyse and propose how to accomplish the reform.

XI OUTLOOK AND CONCLUSIONS

The measures taken by the Spanish government in recent years were intended to simplify the tax legislation, and to increase the taxes collected by means of a rise in VAT and personal income tax rates, and restrictions on the use of CIT tax credits and deductions.

Due to the improvement in the Spanish economy, however, it is more likely that, rather than tax increases, specific tax cuts will be implemented in the near future (e.g., to the personal income tax, where tax rates may be lowered to pre-crisis levels).

In any event, as indicated, the Spanish government has already appointed a committee that will propose ideas on how to carry out the reform of the Spanish fiscal system. The outcome of the committee's efforts will be announced in the first quarter of 2014.

Appendix 1

ABOUT THE AUTHORS

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Uría Menéndez
At the time of writing José Gabriel Martínez Paños was a lawyer in Uría Menéndez's Madrid office. He joined the firm in 2000. He was based in the firm's New York office for almost three years (2004 to 2007), where he headed up its tax practice. He became a senior associate in 2009.

Mr Martínez focuses his practice on corporate tax, non-residents tax and international tax planning. He regularly advises multinationals with a presence in Spain as well as Spanish investors abroad. He also has extensive experience on the tax implications of merger and acquisition transactions and related corporate law issues. He is a regular speaker on his field of expertise at law seminars and conferences.

Mr Martínez's practice areas include corporate tax law, taxation of merger and acquisition transactions, international tax planning and corporate law. His qualifications include a law degree (2000) and a business administration degree (2001) from Universidad Pontificia de Comillas (ICAI-ICADE), Madrid.

Mr Martínez was previously a lecturer of tax law at the Universidad Rey Juan Carlos of Madrid. He is currently a lecturer at the Universidad Pontificia de Comillas (ICAI-ICADE), Madrid.

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