



# SPAIN

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## LIST OF ABBREVIATIONS

<b>Budget Law</b>	Law 62/2003, of 30 of December, Budget Law implementing the provisions of the Directive into Spanish Law
<b>Directive</b>	Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States
<b>GTL</b>	Law 58/2003, of 17 December, General Tax Law
<b>Merger Directive</b>	Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States
<b>OECD</b>	Organization for Economic Cooperation and Development
<b>OECD MC</b>	OECD Model Tax Convention 2003
<b>Parent-Subsidiary Directive</b>	Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
<b>Savings Directive</b>	Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments
<b>TRLIRNR</b>	Non Residents Income Tax Law
<b>TRIRPF</b>	Personal Income Tax Law
<b>TRLIS</b>	Corporate Income Tax Law



## **LIST OF LEGAL REFERENCES**

- Law 58/2003, of 17 December, General Tax Law (Ley General Tributaria), published in the Spanish Official Gazette of December 18, 2003.
- Law 62/2003, of 30 December, Budget Law (Ley de Presupuestos Generales del Estado para 2004), published in the Spanish Official Gazette of December 31, 2003.
- Royal Legislative-Decree 3/2004, of March 5, on Individual Income Tax Law (Texto Refundido de la Ley del Impuesto sobre la Renta de las Personas Físicas), published in the Spanish Official Gazette of March 10, 2004.
- Royal Legislative-Decree 4/2004, of March 5, on Corporate Income Tax Law (Texto Refundido de la Ley del Impuesto sobre Sociedades), published in the Spanish Official Gazette of March 10, 2004.
- Royal Legislative-Decree 5/2004, of March 5, on Non-Residents Income Tax Law (Texto Refundido de la Ley del Impuesto sobre la Renta de No Residentes), published in the Spanish Official Gazette of March 10, 2004.

## PART I. IMPLEMENTATION OF THE DIRECTIVE

### 1. INTRODUCTION

#### 1.1. GENERAL INFORMATION ON THE IMPLEMENTATION OF THE DIRECTIVE

In order to minimize the immediate impact of the entrance in force of Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States (the "Directive") in the Spanish budgets, Art. 6 of the Directive allowed Spain to delay the effective application of the Directive until the effective application of the Savings Directive (1 July 2005) and to apply a transitional tax period during six years, with respect to royalties. Accordingly, the tax rate for royalty payments to an associated company of another Member State or to a permanent establishment situated in another Member State could not exceed 10% during the six years of the transitional period.

Budget Law 62/2003 of 30 December 2003 implemented the provisions of the Directive, in due time, with respect to royalties, following the transitional periods laid down in the Directive.

In respect of interest, it should be noted that prior to the implementation of the Directive, Art. 13 TRLIRNR already laid down the exemption of interest paid to EU residents.

The articles of the Directive have been implemented in the following provisions in the Spanish legislation:

Articles of the Directive	Relevant sections of Spanish laws
Art. 1	Art. 14.1 b) TRLIRNR for interest Art. 25.1 i) TRLIRNR for royalties (transitional period)
Art. 2	Art. 23.2 TRLIRPF for interest and Art. 13.1 f) 3 TRLIRNR for royalties
Art. 3	No implementation for interest. As for royalties, Art. 25.1 i) 4 TRLIRNR for associated companies and Art. 13.1 a) TRLIRNR for permanent establishments
Art. 4	No implementation
Art. 5	Art. 25.1 i) TRLIRNR
Art. 6	Art. 25.1 i) TRLIRNR for royalties only
Art. 7	Art. 4 Budget Law

## **1.2. TAX TREATMENT OF INTEREST AND ROYALTY PAYMENTS UNDER GENERAL TAX LAW**

### **1.2.1. Domestic rules**

Taxable income, for Spanish corporate income tax purposes, coincides with the commercial profits as shown in the commercial accounts, corrected by some adjustments. Therefore, interest and royalties received by Spanish residents is fully taxable.

On the other hand, interest and royalties paid by Spanish residents is fully deductible if paid on an arm's length basis.

The standard withholding rate on interest paid to non-residents is 15% (some exemptions apply to interests on loans and from treasury bonds). The withholding tax on royalties paid to non-residents, including payments for know-how, is 25%.

Deductibility of interest is disallowed where thin capitalization rules apply. Thus, if the average total loans made to a company resident in Spain by a non-EU resident related company during the tax year is more than three times the amount of the borrower's average net worth in that year (excluding profits of the period), the amount of interest attributable to the excess will be re-characterized as a dividend for tax purposes, and thus, will not be deductible and will be subject to dividend withholding tax.

### **1.2.2. Treaties**

Spain has effective tax treaties with all EU Member States with exception of Malta and Cyprus (see Annex). In respect of interest or royalty payments, all tax treaties signed by Spain with each Member State generally follow the provisions of Articles 11 and 12 OECD MC. The Spanish tax treaties, however, usually allow imposition of withholding tax on royalties in the state of source.

In this sense, the usual tax rate for interest is 10%, although certain treaties may provide for more reduced rates (e.g. Poland 0%). As for royalties, Spanish treaties usually provide for 5%-10% withholding tax rates. As in the case of interest, certain treaties with other EU-residents provide for lower rates (e.g. Hungary 0%).

## 2. SCOPE

### 2.1. PAYMENTS

#### 2.1.1. Concept of interest

##### *a. Definition*

Art. 14.1 c) of the TRLIRNR lays down the definition of interest for Spanish legislation purposes:

*"Interest and other returns obtained by the assignment of own capital to third parties to which Art. 23.2 of Royal-Legislative Decree 3/2004, of 5 of March on Personal Income Tax and Other Tax Rules refers (...)."*

Said Art. 23.2 provides for the following definition:

*"2. The return obtained on the assignment of own capital to third parties. Considerations of all kinds, regardless of their name or nature or of whether they are monetary or in kind, such as interest and any other kind of payment agreed to remunerate such an assignment, together with income derived from the transfer, reimbursement, redemption, exchange or conversion of any kind of assets representing the capturing and use of third-party capital shall be considered as such.*

*a) In particular, the following shall be considered as such:*

*1 The return on any draft, including those originating from trading operations, as from the moment at which it is endorsed or transferred, unless the endorsement or credit is made in payment of a credit from suppliers or providers.*

*2 The consideration, irrespective of its name or nature, derived from accounts at all kinds of financial institution, including those based on financial asset transactions.*

*3 The return derived from the temporary assignment of financial assets with a repurchase agreement.*

*4 The return paid by a financial entity as a consequence of the full or partial transmission, assignment or transfer of a credit held thereby.*

*b) In the case of transfer, reimbursement, redemption, exchange or conversion of securities, the differences between the transfer, reimbursement, redemption, exchange or conversion value thereof and the acquisition or subscription value shall be computed as a return.*

*The exchange or conversion value shall be the value that corresponds of the securities received.*

*Ancillary acquisition and disposal expenses shall be computed in order to quantify the return to the extent that they are adequately supported.*

*Losses derived from transfers of financial assets shall, when the taxpayer has acquired homogenous financial assets during the two months before or after said transfers, be included to the extent that the financial assets that remain in the taxpayer's wealth are transferred."*

This definition covers the scope of the concept of interest under the Directive. It describes a concept of interest more extensive and detailed than the definition in Art. 2 of the Directive.

##### *b. Exclusion of hybrid financial arrangements (Art. 4(1) b)-d))*

Spain has not used the option to exclude payments under financial arrangements listed in Art. 4 (1) b), c) and d) of the Directive.



*c. Exclusion of interest reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))*

Spain has not specifically used the option to deny the exemption to interest reclassified as profit distribution (Art. 4 (1) a) of the Directive), or to implement the “*special relationship*” clause in Art. 4 (2).

Spanish thin capitalization rules do not apply to interest paid to EU residents.

Although this is not a crystal-clear issue, some authors take the view that under the Spanish transfer pricing provisions (Art. 16 TRLIS), one may get to a similar result where from the overall appreciation of non-arm's length transactions between related parties, they have resulted in a tax deferral or in a lower tax being collected in Spain. The definition of related parties is complicated and encompasses direct and indirect shareholdings as well as de facto control situations.

In a case, for instance, where a Spanish entity has paid non-arm's length interest to its EU resident shareholder, the Spanish tax authorities could adjust the whole transactions, by considering that an overall loss of taxes took place in Spain, since the Spanish company deducted the interest at a 35% rate while the EU resident was not taxed in Spain by virtue of the Directive.

### **2.1.2. Concept of royalties**

*a. Definition*

Under Art. 12.1 f) TRLIRNR, royalties are defined as returns of every kind paid for the use, or the right to use:

- copyright of literary, artistic or scientific work including cinematograph films;
- any patent, trade mark, design or model, plan, secret formula or process;
- rights to use software;
- information concerning industrial, commercial or scientific experience;
- personal rights, as the right to use the personal image;
- industrial, commercial or scientific equipment;
- any similar right.

In addition, the law provides that payments for the use or the right to use those rights covered under the Industrial Property Law and Trade Mark Laws, are considered as royalties.

This definition appears slightly broader than the one in the Directive, since it also mentions personal rights, such as the right to the personal image.

*b. Classification of revenue from leasing and software*

Under the traditional Spanish treaty policy, both leasing and software income have been considered as a royalty.

This view has been expressed by Spain in a reservation to Art. 12 OECD MC, regarding leasing of industrial, commercial or scientific equipment and of containers (paragraph 45 of the Commentaries to Art. 12 of the 2005 OECD MC).

In the case of software, paragraph 28 of the Commentaries to Art. 12 of the 2005 OECD MC contain an observation under which Spain holds the view that payments relating to software

are royalties where less than the full rights to software are transferred either if the payments are in consideration for the right to use a copyright on software for commercial exploitation or if they relate to software for the business use of the purchaser, when in this last case, the software is not absolutely standardized but somehow adapted to the purchaser.

Therefore, both Spanish domestic and treaty law consider leasing or software payments as royalties. Accordingly, under domestic law, leasing or software payments would be subject to the reduced 10% withholding tax rate authorized to Spain under Art. 6 of the Directive (in practice, please note, that virtually all Spanish treaties in force with other Member States provide for a lower rate).

*c. Exclusion of royalties reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))*

The same transfer pricing rules apply to royalties (see 2.1.1 c. *Exclusion of interest reclassified as profit distribution or conflicting arm's length* above).

## **2.2. COMPANIES**

### **2.2.1 Types of companies benefiting from implementing provisions (Art. 3(a)(i))**

#### *a. Other types of entities*

In the case of interest, Spain has not made any reference to the Annex. Thus, it can be understood that the exemption applies to entities of any legal form, as long as it is considered resident in an EU Member State. There are no restrictions as to form in relation to paying entities resident in Spain.

As for royalties, Spain limits the benefits under the Directive to entities listed in the Annex of the Directive (Art. 25.1.i) 2 TRLIRNR). This applies both to Spanish entities making a payment and to the recipients of income resident in the EU.

#### *b. Hybrid entities*

Under Spanish law, the hybrid or corporate nature of an entity depends on its legal nature. Accordingly, Spanish law provides for an "attribution of income regime" applicable to joint ownerships, estates of deceased persons, civil companies and other entities without legal personality in Spain but holding assets. The "attribution of income regime" generally applies within Spain and in certain cases as well to any foreign entity of identical or analogous nature (e.g. trusts and French partnerships). These entities could then be considered as hybrid entities. Under the "attribution of income regime", the entity is looked through and income is attributed to its member or partners. However, no guidance has been issued with respect to application of the "attribution of income regime" in situations covered by the Directive.

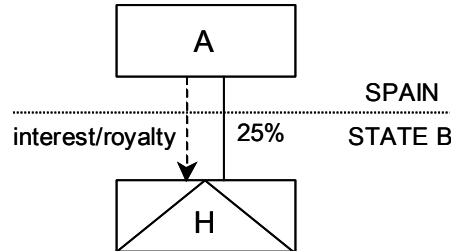
The issue of tax treatment of payments in situations involving hybrid entities is considered based on three hypothetical situations described below:

- Case 1: a Spanish associated company pays interest and royalties to a hybrid entity H located in Member State B;
- Case 2: a Spanish hybrid entity H pays interest and royalties to an associated company in Member State A;

- Case 3: a Spanish associated company pays interest and royalties to an associated company through a hybrid entity H, the latter two located in Member State A.

Case 1: Payment to a hybrid entity

A Spanish associated company A pays interest and royalties to a hybrid entity H situated in Member State B. Spain treats hybrid entity H as a transparent entity.



Please note that in a case like this, it could be important to know the residence of the partners of the hybrid entity. However, the answers below are given assuming the hybrid has obtained a certificate of residence in Member State B.

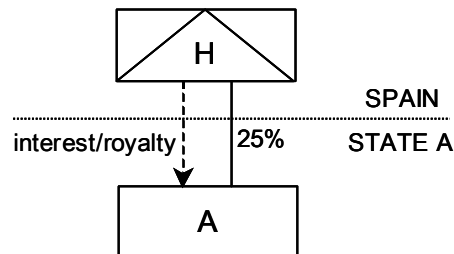
In respect of interest, the exemption under the Directive would apply only if the hybrid entity H is considered to be resident in EU under general domestic rules (see 3. PROCEDURE below for requirements to prove residency in an EU Member State).

In respect of royalties, the 10% rate would apply only if the legal form of the EU hybrid were mentioned in the Annex to the Directive, and all other conditions were met (see comments on residency, "subject-to-tax", etc. below).

If "attribution of income regime" is applied in this situation, interest would benefit from the general exemption under domestic law provided that members of the hybrid entity are resident in the EU, and the reduced rate for royalties would apply if the members comply with all the criteria under the implementing provisions. Although the look-through approach should be applied, there is no guidance on this issue and the tax authorities might not follow it in practice.

Case 2: Payment from a hybrid entity

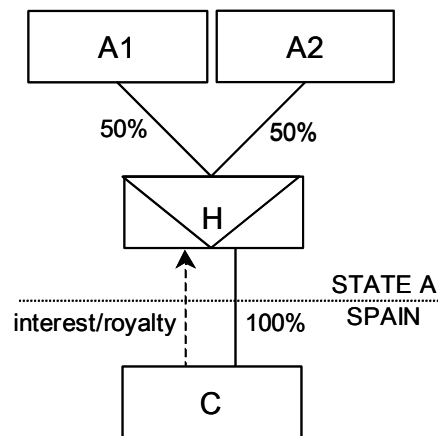
A hybrid entity H in Spain pays interest or royalties to an associated company A in Member State A.



In respect of interest, the exemption would apply, since the only condition is that the interest is received by an EU resident. In respect of royalties, the 10% reduced rate would not apply, since the legal form of the Spanish hybrid is not mentioned in the Annex to the Directive (i.e. the legal forms mentioned with respect to Spain are all corporate entities).

Case 3: Payment through a hybrid entity

Companies A1 and A2 are the members of the hybrid entity H, all located in Member State A. The hybrid entity H holds all the shares in company C, located in Spain. Spain treats hybrid entity H as a transparent entity. Company A1 grants a loan to the hybrid entity H and the hybrid entity H grants a loan to the company C. Interest flows from the company C to a member A1 through the hybrid entity H.



Spain has not implemented look-through rules for these cases. Therefore, the rules on Case 1 described above should apply.

Please note that the above rules would not be applicable if the hybrid entity receiving the interest or royalty would have a permanent establishment in Spain to which the interest or royalty might be attributed.

**2.2.2. Residence requirement (Art. 3(a)(ii))**

*a. Implementation of the requirement*

As for interest, Art. 14.1 c) TRLIRNR only requires that the recipient is resident in the EU, but not in a listed tax haven. Within the EU, Malta, Cyprus and 1929 exempt Luxembourg holding companies are listed as tax havens.

As for royalties, under Art. 25.1 i) 3 TRLIRNR, Spain has implemented the residence requirement in the same terms of Art. 3 of the Directive, i.e. both companies must be EU residents and must not, within the meaning of a tax treaty concluded with a third state, considered to be resident for tax purposes outside the Community.

*b. Application of the requirement in dual residence cases*

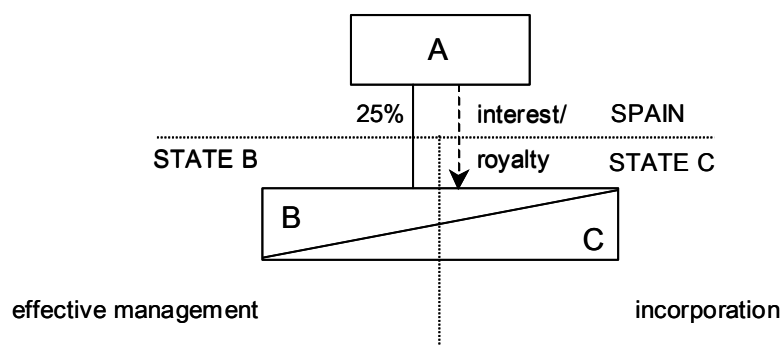
There is no specific guidance with respect to application of exemption from withholding tax when interest or royalties are paid to or from dual resident companies. The conclusions on the tax treatment of such payments are drawn on the basis of general implementing provisions.

The issue of tax treatment of payments in situations involving dual residency is considered based on three situations described below:

- Case 1: a Spanish associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in Member State B;
- Case 2: a dual resident company BC incorporated in Member State C but with its effective management in Spain makes an interest or royalty payment to an associated company A resident in Member State A;
- Case 3: a dual resident company BC incorporated in Spain but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.

Case 1: Payment to a dual resident

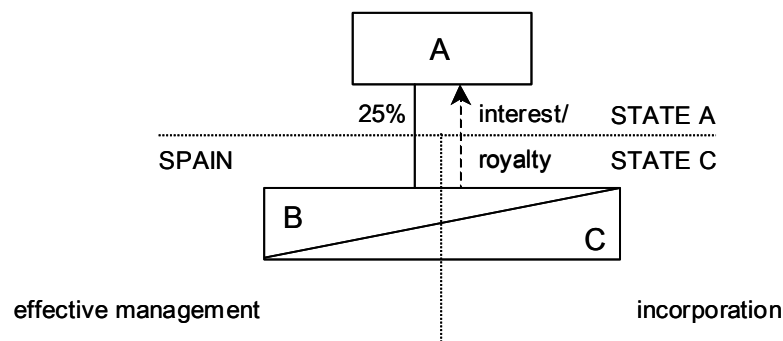
A Spanish associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in Member State B.



Where a recipient company is resident in two Member States at the same time, this residency requirement would be met and the benefits of the Directive would be granted.

Case 2: Payment by a dual resident with the place of management in Spain

A dual resident company BC incorporated in Member State C but with its effective management in Spain makes an interest or royalty payment to an associated company A resident in Member State A.

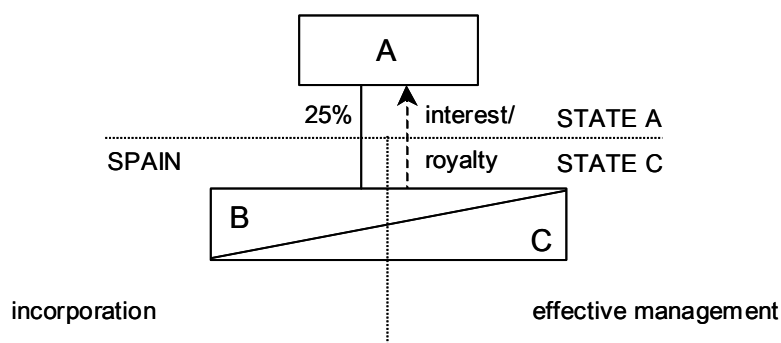


If a company making interest or royalty payment is a dual resident of Spain and another Member State, Spanish law does not provide for any tie-breaker rule in order to determine the effective source-country. Under Spanish law, a company is tax resident either (i) it has been incorporated under Spanish law, (ii) it has its social domicile in Spain, or (iii) it has its place of effective management in Spain. Therefore, the company BC would be tax resident in Spain and the benefits under the Directive should be granted.

In cases like this, although, the issue could be resolved under the tax treaty tie-breaker rules, however, there is no guidance on this issue. Assuming that the tax treaty between Spain and Member State C follows the OECD MC, it would designate Spain as the country of residence of the company BC. There are no grounds to deny the benefits under the Directive in this case.

#### Case 3: Payment by a dual resident with the place of incorporation in Spain

A dual resident company BC incorporated in Spain but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.



In this situation, the tax treatment described for Case 2 above applies. If the company BC would be resident in Member State C under the tax treaty between Spain and Member State C, the benefits of the Directive would be granted if there is a permanent establishment of the company BC in Spain. If such permanent establishment does not exist (which is a theoretical situation as the Spanish tax authorities would most probably refuse to treat the company BC as resident in Member State C only), income would have no source in Spain and no withholding taxes would apply.

#### **2.2.3. Subject-to-tax requirement (Art. 3(a)(iii))**

This requirement has not been transposed in the case of interest.

As for royalties, Art. 25.1 i) 1 TRLIRNR requires that both companies are subject and not exempt to one of the tax listed in Art. 3 a) iii) of the Directive.

Thus, the Spanish legislator has implemented this provision, by referring to the subjection of the company to tax and not of the income.

As for the treatment of interest and royalties paid to hybrid entities of another Member State, a difference must be made between both items of income. In the case of interest, as

mentioned, no subject-to-tax requirement exists. Thus, the exemption is applicable as long as a hybrid entity is an EU resident. In the case of royalties, however, since the law requires that the recipient company must be subject to a tax mentioned in the Directive, this could hinder the application of the reduced rate. Please note that, as mentioned below, Spain has not made use of the possibility of asking for an attestation of the fulfillment of all the requirements prior to the granting of the reduced rate.

#### **2.2.4. Associated company (Art. 3(b))**

In the case of interest, there is no ownership threshold. Interest paid to EU resident companies is exempt irrespective of any affiliation with a Spanish entity.

As for royalties, Art. 25.1 I) 4 TRLIRNR defines "associated company" as if, at least, the first company has a direct minimum holding of 25% in the capital of the second company, or the second company has a direct minimum holding of 25% in the capital of the first company, or a third company has a direct minimum holding of 25% in the capital of both, first and second company. This requirement reflects the criteria of an "associated company" under Art. 3 (b) of the Directive.

Therefore, for royalties:

- Spain does not apply a lower threshold than the one in the Directive;
- it has not extended its benefits to situations of indirect holdings; and
- it has not made use of the it option to require voting rights.

No reference is made to participations held by hybrid entities (see 2.2.1. *b. Hybrid entities* above on the general Spanish practice with respect to the treatment of hybrid entities).

#### **2.2.5. Beneficial ownership (Art. 1(4))**

No beneficial ownership provision has been implemented in respect of interest.

As for royalties, Spain has implemented Art. 1 (4) of the Directive under Art. 25.1 i) 6 TRLIRNR. Accordingly, the source company shall be treated as the beneficial owner of royalties only if it receives those payments for its own benefit and not as an intermediary or authorized signatory for some other person. This provision is not related to the subject-to-tax requirement in Art. 3 a) (iii) of the Directive.

Neither the tax authorities nor the Spanish Tribunals have issued any guidance or decision on the interpretation of this criterion yet.

### **2.3. PERMANENT ESTABLISHMENTS**

#### **2.3.1. Definition (Art. 3(c))**

The Spanish domestic definition of permanent establishment in Art. 13.1 a) TRLIRNR has not been modified by the Directive.

Therefore, an individual or entity shall be considered to operate through a permanent establishment in Spanish territory when he/it in any way continuously or habitually uses therein installations or work places of any kind in which he/it carries on all or part of his/its activity or when he/it acts herein through an agent authorized to enter into contracts in the name and for the account of the taxpayer who uses said powers habitually. In particular, management, headquarters, branches, offices, factories, plants, warehouses, shops or other

establishments, mines, oil or gas wells, quarries, agricultural, forestry or livestock operations or any other place of prospecting for or extraction of natural resources, and building, installation or assembly works with a duration of over 6 months shall be considered permanent establishments.

This definition is very similar to the one used in Spanish tax treaties, with the main difference that it does not exclude auxiliary activities.

### **2.3.2. Application of source rules (Art. 1(2))**

To our knowledge, there has not been any instances where Spain has interpreted Art. 3 c) of the Directive more narrowly than Art. 5 of the OECD MC.

### **2.3.3. 'Tax-deductible expense' requirement (Art. 1(3))**

If a payment made by a permanent establishment is a tax-deductible expense, it is deemed to be borne by that permanent establishment and triggers application of the implementing provisions in qualifying situations.

The deductibility of interest payment is not necessarily a condition for the application of the benefits under the implementing provisions. If the payment is deemed to be made by the permanent establishment, irregardless whether it is deductible, the benefits under the Directive would apply. If it is not deductible, no withholding obligation would arise under general domestic rules.

For royalties, the law requires explicitly that it must be deductible for tax purposes in order the reduced rate to apply (Art. 25.1 i) 5 TRLIRNR).

### **2.3.4. Beneficial ownership (Art. 1(5))**

There is no beneficial ownership provision related to interest.

As for royalties, a permanent establishment is treated as the beneficial owner of the royalties if the payments related to those royalties are effectively connected with the activity of the permanent establishment and represent taxable income in the State where the permanent establishment is situated (Art. 25.1.i) 6 TRLIRNR). There is no definition of "effectively connected".

There is no relation between this provision and Art. 3 (a) of the Directive.

### **2.3.5. Permanent establishment in a third country (Art. 1(8))**

The exemption for interest (Art. 14.1 c) TRLIRNR) and the reduced rate for royalties (Art. 25.1. i) TRLIRNR) do not apply if the payment is made to a permanent establishment in a third state.



### 3. PROCEDURE

In the case of interest, the only requirement to be met is that the related entity is resident in the EU. If this is the case, the exemption is granted without prior decisions or attestations.

In the case of royalties, there is a minimum holding period that can be completed before or after the payment has been made. If all requirements are met, the source company may apply the reduced rate directly without a prior decision or attestation.

The law does not require a certification of residency to prove that the recipient is a resident of an EU Member State. However, in administrative practice, in order to apply the exemption or a reduced rate, it will be necessary for the recipient of the interest or royalties to produce a certificate of residence at the time of payment.

#### 3.1. MINIMUM HOLDING PERIOD (ART. 1(10))

##### 3.1.1. General

In the case of interest, no minimum holding period applies.

As for royalties, the minimum holding period is considered to be complied with when the participation has been held for at least one year before the payment or kept for the remaining period afterwards.

##### 3.1.2. Relief before the holding period requirement is satisfied

As mentioned above, in the case of royalties, the reduced rate applies also to cases where the one-year shareholding period is completed after the payment. No details are given in the law as of how to proceed in these cases (taxation and refund, provision of warranties, etc.).

##### 3.1.3. Appeals

If a requirement was not regarded as fulfilled, an appeal would be possible, in the same way as appeals by domestic taxpayers.

#### 3.2. ATTESTATION (ART. 1(11) AND 1(13))

Spain does not require an attestation for applying the reduced withholding tax for royalties, or the exemption for interest.

#### 3.3. DECISION ON APPLICATION OF THE RELIEF (ART. 1(12))

Spain does not require a decision in order to apply the reduced withholding tax for royalties or the exemption for interest.

### **3.4. APPLICATION FOR REFUND (ART. 1(15) AND 1(16))**

With respect to interest, Spain applies the general exemption system. With respect to royalties, during a transitional period a 10% rate is authorized under Art. 6 of the Directive. A taxpayer could apply for a refund of overpaid taxes. The statutory limitation period is 4 years. The tax authorities are obliged to decide on the refund request, but the law does not set any time limits. However, after 6 months, the taxpayer may assume that its request has been denied and may appeal before the Economic-Administrative Tribunals, an administrative body incardinated in the structure of the Spanish Ministry of Finance, composed mainly of tax inspectors, but not subject to the hierarchy principle.

The Economic-Administrative Tribunals are also obliged to address the appeal, but without time limit. After one year, the taxpayer can lodge an appeal before the Ordinary Courts.

If the taxpayer's position is confirmed, interest from late payment will apply as of the payment date.

## **4. FRAUD AND ABUSE (Art. 5)**

### **4.1. MEASURES UNDER ART. 5(1) OF THE DIRECTIVE**

#### **4.1.1. Domestic**

Spanish Law contains general anti-abuse clauses, such as a substance-over-form rule (Art. 16 GTL) and the *fraus legis* doctrine (Art. 15 GTL). These rules potentially apply to any transaction, including interest and royalty payments made by Spanish resident companies falling under the implementing provisions of the Directive.

#### **4.1.2. Agreement-based**

The tax treaties with Estonia, Ireland, Latvia, Lithuania, Portugal and Slovenia, contain a limitation on benefits provision, according to which the reduced rates or exemptions agreed under the interest and royalties provisions are not of application where at least 50% in the company deriving the income belongs to a resident in a third state, and such company does not carry out active businesses, other than the mere holding of shares. Please note that these rules could be contrary to EC Law, in accordance with the doctrine of the ECJ in the “Open Skies” cases, although this has not become an issue yet.

Additionally, Art. 12 of the tax treaty between Spain and the United Kingdom provides that the provisions of the treaty in relation to royalties would not apply if the right or property giving rise to the royalties was created or assigned mainly for the purpose of taking advantage of the treaty and not for bona fide commercial reasons.

This provision is unique among the tax treaties concluded by Spain with other Member States, and it is a clear example of an anti-abuse measure.

### **4.2. MEASURES UNDER ART. 5(2) OF THE DIRECTIVE**

Spanish legislation denies the application of the reduced rate provided for royalties under Art. 25 TRLIRNR, where most of the voting rights in the beneficial owner are held, directly or indirectly, by individuals or companies which do not reside within the EU, unless it is proven that such company has been established for valid economic reasons and not to benefit unfairly from the application of such rate.

### **4.3. COMPARISON WITH SIMILAR MEASURES UNDER PARENT-SUBSIDIARY AND MERGER DIRECTIVES**

The Spanish implementation of Parent-Subsidiary Directive has made use of the possibility to introduce anti-avoidance clauses. Thus, under Art. 14.1 h) TRLIRNR the exemption on dividends does not apply where:

- the parent company is resident in a the listed tax havens (see section 2.2.2. above); or
- the ultimate parent company of the company to which the dividend is paid is resident outside the EU, where the majority of the voting rights in the EU parent company is directly or indirectly held by individuals or companies not resident in any EU Member State.

The exemption would still, however, apply if it can be established that one of the following situations applies:

- the EU parent company is in fact conducting a business directly linked to the Spanish subsidiary's business;
- the EU parent company 's purpose is the management of the Spanish subsidiary;
- evidence can be given that the EU parent company was incorporated on sound economic reasons and not only to benefit from withholding tax exemption.

This anti-avoidance rule is almost identical to the one established for payment of royalties under Art. 25 1. i) TRLIRNR, except for the first two "safe harbours" mentioned in Art. 14.1 h) TRLIRNR, which are typically related to holding companies.

With respect to anti-abuse provision under the Merger Directive, Art. 96.2 TRLIS establishes that the tax neutrality regime shall not apply where the main purpose of the transaction is tax fraud or tax evasion. In particular, the regime shall not apply where the transaction is not performed for valid economic reasons, such as the restructuring or rationalization of the activities of the entities participating in the transaction, but rather merely to achieve a tax advantage. Thus, this anti-avoidance rule is rather different from the one established for royalties under the Directive.

## 5. SUMMARY

The Directive precludes any taxation on interest and royalty payments to associated EU companies generally with effect from 1 January 2004. Spain, however, has been granted a transitional regime under which it enjoys an exemption from the application of the Directive until 1 July 2005. Thereafter, Spain may levy a withholding tax on royalties at 10% for 6 years, from 1 July 2005 to 30 June 2010. However, under the current legislation, the reduction to 10% has already taken place from 1 January 2005 with respect to qualifying payments. Thus, royalty payments by Spanish companies are currently subject to withholding tax at a reduced rate of 10%, provided that the recipient is an associated company of the paying company and is resident in another EU Member State.

Please note that interest derived by companies resident in other Member States (excluding Luxembourg exempt holding companies) or EU-situs permanent establishments of EU residents were already exempt before the Directive entered in force.

### Scope

Spain generally implemented all the relevant provisions of the Directive.

The exemption on interest paid to EU residents applies irrespective of the legal form of the payer and the recipient of income. The only applicable requirement is that the recipient of interest must be resident in an EU Member State.

The reduced rate on royalties applies when the conditions of the legal form, beneficial ownership and the ownership thresholds are satisfied. The minimum holding period for associated companies is one year, but there is an opportunity to apply the reduced rate before the holding period is met.

### Procedure

The only articles not implemented were the ones referred to the attestation or the prior decision, provisions which implementation was optional for the Member States.

### Fraud and abuse

Both general and specific anti-abuse measures apply. The specific anti-abuse measure under Art. 5(2) limits the benefits to situations where most of the voting rights in the beneficial owner are held, directly or indirectly, by persons not residing within the EU, unless a company has been established for valid economic reasons and not to benefit unfairly from the application of the reduced rate.



## **PART II. THE AGREEMENT**

By virtue of Art. 18 (3) of the Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, its provisions do not apply in respect of Spain until a bilateral agreement has been concluded between Spain and Switzerland on the exchange of information in administrative, civil or criminal cases of tax fraud. Such an agreement has not been signed yet at the time of writing this report and, thus, no information can be given in this respect.

## ANNEX

Table of the maximum withholding tax rates on interest and royalty payments under the tax treaties between Spain and the EU Member States.

EU Member State	Interest (%)	Royalties (%)
Austria	5	5
Belgium	10	5
Czech Republic	0	0/5 <1>
Denmark	10	6
Estonia	10	5/10 <2>
Finland	10	5
France	0/10 <3>	0/5 <1>
Germany	10	5
Greece	0/8 <3>	6
Hungary	0	0
Ireland	0	5/8/10 <4>
Italy	0/12 <3>	4/8 <1>
Latvia	10	5/10 <2>
Lithuania	10	5/10 <2>
Luxembourg	10	10
Netherlands	10	6
Poland	0	0/10 <1>
Portugal	15	5
Slovak Republic	0	0/5 <1>
Slovenia	0/5 <3>	5
Sweden	15	10
United Kingdom	12	10

<1> The lower rate applies to copyright royalties, excluding films, etc.

<2> The lower rate applies to royalties for equipment rentals.

<3> The lower rate applies to interest paid by public bodies.

<4> The 5% rate applies to artistic copyrights, excluding films, etc.; the 8% rate applies to films, etc., any scientific works and any equipment.