International Tax Planning

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Introduction

It is becoming increasingly common, in a globalized economic context, for both natural and legal persons to resort to tax planning as a set of legal strategies designed to reduce the tax burden involved in certain international operations. The concept is related to tax mitigation. When these strategies are extremely sophisticated, they are known as *tax engineering*, a practice which sometimes hovers around the limits of legality.

In tax planning, not only the national legislation of a certain state is used, but also the legislation of other states, as well as international law, particularly double taxation agreements (DTA). In this respect, certain company structures are used that are subject to a favourable tax regime.

However, practices are sometimes used that may lead to tax evasion, to which states respond through conventional or unilateral measures, such as the international tax transparency regime or controls on transfer pricing. This predominantly occurs in the case of related-party transactions conducted by companies that form part of the same group.

Meanwhile, there are territories that offer more advantageous taxation regimes than others, or which have very low or even no taxation, whether as a general rule or in relation to certain individuals or activities. This promotes the occurrence of tax evasion and is what is seen in the case of tax havens.

In short, tax evasion involves the use of fraudulent means for the purpose of avoiding the occurrence of a taxable event that would generate a fiscal obligation (thereby avoiding the payment of the tax) in a territory with high levels of taxation, moving it to territories in which there is very low or no taxation, known as tax havens.

Treaty shopping is another practice that is used to attain the application of a treaty that would not otherwise be applicable, in order to achieve a lower level of tax obligation or none at all.

Objectives

The main objectives for students to strive for when taking this module are as follows:

1. To understand the purpose of tax planning and to be able to differentiate it from tax evasion.

2. To understand the tax treatment of transfer pricing.

3. To gain insight into the phenomenon or treaty shopping.

4. To understand the fiscal regime of international tax transparency.

5. To identify tax havens and measures to combat them.

1. International tax planning

The objective of **tax planning** is to use different strategies designed to reduce the amount of tax that has to be paid, or to defer the payment of the tax corresponding to a certain operation or investment within the framework of legality. In short, it is a matter of tax mitigation.

Along the same lines, the objectives of **international tax planning** are identical, namely achieving lower taxation or a deferral of a tax obligation (regarding both direct and indirect taxation) in the case of foreign investments or investments made by residents abroad, based on the combined use of the taxation systems of different states and DTAs.

In general, although there are countless strategies, they tend to involve **companies** of various structures (holding companies, capital market companies, investment companies or service providers) located in **territories with an attractive taxation regime and a significant DTA network** that enables interactions with other states.

Recommended reading

J. Arespacochaga (1998). *Planificación fiscal internacional*. Madrid: Marcial Pons.

Corporate structures

The corporate structures that are generally used in international tax planning include the following: Dutch BV companies (*Besloten Vennootschap*), Danish holdings, Spanish ETVEs (foreign securities holding companies), Liechtenstein foundations, variable capital investment companies in Luxembourg or Spain (SICAV), Spanish listed limited liability real estate investment companies (SOCIMI), real estate investment trusts (REIT) and trusts.

On occasions, **loopholes** (issues that are not expressly regulated) in the tax legislation or in the DTTs themselves are exploited. The majority of states prohibit the use of equivalence to capitalize on these loopholes in relation to the taxable event, exemptions and other fiscal benefits or incentives (as stipulated in Article 14 of the General Taxation Act).

To qualify as a situation of international tax evasion, two concurrent **factors** are required.

- The existence of two or more taxation systems.
- The taxpayer being able to choose indirectly between these taxation systems in order to structure their activity based on the greatest fiscal benefit that can be achieved.

Tax havens

Tax havens are territories with low or no taxation that can be used to perform international tax evasion operations. However, international tax evasion may be committed using any type of territory and, therefore, a tax haven is not necessarily required for such evasion to exist.

However, there are certain practices involved in international tax planning or fiscal engineering (when extremely sophisticated strategies are used) that stretch beyond legality and fall within the scope of tax evasion (tax offence). This is the case of circumstances in which the domestic tax is avoided in the state of residence (it is not declared or paid), and with the relocation of the transaction the competent tax authorities are not given the relevant information, so that it is deemed to have been executed in a territory classified as a tax haven or in which tax secrecy exists. Sometimes, through the use of trickery, a situation is contrived in which the operation is subject to the application of a convention that would not otherwise be applicable. Other strategies include using operations as artificial arrangements, as a front, or without a real presence, as a mailbox.

To combat these situations, both in terms of treaties and unilaterally, states adopt general anti-abuse clauses or clauses prohibiting certain operations that lower the tax burden (whereby legislators reclassify the operations from a certain limit upwards so as to prevent evasion).

Specific anti-abuse clauses

In these cases, the tax regime applicable to the transaction is applied below a limit set by legislators, leading to a type of tax mitigation situation known as *safe harbours*. An example of such a clause can be found in Article 16 of the Corporate Tax Act, which limits which financial expenses are deductible.

Spanish general anti-abuse clause

The General Taxation Act establishes a general anti-abuse clause, known as conflict in the application of tax regulations (formerly referred to as *fraudulent evasion of tax law*). This concept arises when the occurrence of the taxable event is totally or partially avoided or the taxable base or tax obligation is mitigated by means of acts or dealings which, taken individually or as a whole, are blatantly contrived or improper and designed to bring about the result obtained, the use of which does not lead to any significant legal or financial effects other than tax savings and avoiding effects that would have been obtained with the usual or proper acts or dealings[1].

(1) Art. 15 LGT.

In such cases, the Authorities can settle the tax irrespective of the fiscal benefits gained and applying the tax regulations that would have applied to the usual or proper acts or dealings. The corresponding interest on late payment of the tax obligation can be demanded, but not the fiscal penalties.

Example

Ms. Rodríguez owns a flat that she wishes to transfer to Mr. Pérez in exchange for a price. Instead of signing a contract of sale, they set up a company, into which Ms. Rodríguez contributes with the property and Mr. Pérez contributes with the capital. Shortly afterwards, they dissolve the company and Ms. Rodríguez is assigned the money, while Mr. Pérez is awarded the real estate. In this way, they avoid payment of the tax on the sale of property. Does this transaction constitute fraud?

In order to determine whether or not this is a case of fraud, or conflict in the application of tax regulations, we have to analyse whether two requirements have been met concurrently: firstly, contrived and improper acts and, secondly, that a tax saving has been achieved. In this situation, we have a case of contrived and improper acts, as the normal or usual transaction to obtain such a result would be a contract of sale, rather than incorporating and then dissolving a company. Meanwhile, the sole effect achieved is a tax saving, as the taxes applied to the sale of property are avoided. No other effects are achieved other than the tax saving, in view of the fact that the company does not cause any significant legal or financial effects. It is a company without a real business activity. Therefore, the two requirements are met to classify this transaction as a conflict in the application of tax regulations, or fraud.

DTAs sometimes expressly stipulate the application of such general clauses, but not always. Moreover, the application of such clauses may lead to a result that contradicts the DTAs themselves.

2. Transfer pricing

On occasions, in order to value the income generated by certain transactions, Spanish legislation stipulates that the market value should be applied, as is the case in **related-party transactions** between companies in the same group, in which the prices between them can vary (up or down), and which are disclosed with prices that do not reflect the reality of the market.

This is an extremely important issue in the case of **multinational groups**, in which the groups of the company, within a framework of careful tax planning, often agree prices that differ from the market price in order to achieve a tax saving. This leads to a reduction in the taxable bases, which results in lower tax revenue for the states in which the companies are based.

How it works

This strategy involves overcharging for goods or services exported from a country with low taxation to a country with higher taxation. In short, the larger profit is made in the state with the lower taxation (or in which losses can be used to compensate for profits gained) and the greater expenses are incurred in the state with the higher taxation.

In response, the tax regulations of the different countries take action against transactions between related companies by establishing mechanisms to prevent evasion and profit transfers from some companies to others hidden under the guise of another type of business. This phenomenon has become a major concern for Tax Authorities in view of the fact that, as a result of the globalization of the economy, the greatest volume of international transactions take place in this precise ambit, between related companies.

In effect, the tax authorities are suspicious of these transactions between related companies because they pose a threat to tax revenue agencies, as such operations can be used to reduce the amount of taxable profit, with a negative impact on revenue, by effectively conducting profit transfers or deferring payment of the tax. Such tactics, which obviously represent considerable losses of revenue for the tax agencies in the different states, are often extremely difficult for the Tax Authorities to control.

Transfer pricing

The financial considerations agreed by the parties are often referred to as *transfer prices*.

Related-party transactions are characterized by three features:

- They are performed between parties that share a special relation.
- They involve financial considerations being agreed that differ from those that would be agreed by two independent parties in a normal market context.
- The agreement is made precisely by virtue of the relation that connects them, insofar as they would not make such an agreement with a third party.

In terms of the response of the authorities to transfer pricing, in the case of related-party transactions, tax legislation often establishes the arm's length principle (also referred to as the **level playing field principle**, independent operator rule, principle of free competition and the rule of the normal price on the open market) or, in other words, it views the transaction as if it were conducted between independent parties, considering the income to be the income that would have been generated by sales at the normal market price (regardless of the fact that, in reality, they obtained a lower income).

As a result, this type of transaction can be monitored and reviewed by tax authorities to adjust their price to the market value. To this end, Tax Authorities must make a series of **tax adjustments to the taxable bases** of the companies, regardless of whether or not the transfer prices were wilfully set for this purpose.

Bilateral tax adjustment

This adjustment is bilateral in the sense that, as well as a positive adjustment in one company (i.e. an increase in the taxable base), a negative adjustment is applied in the other company (i.e. a reduction in the taxable base or correlative adjustment). Article 9 of the OECD Model Tax Convention deals with this issue.

1) The OECD and DTAs

For the purpose of controlling the arm's length principle, the Organisation for Economic Cooperation and Development (OECD) has proposed a series of **methods** designed in each case to create clear comparative rules, taking into consideration aspects such as the characteristics and nature of the goods, services transferred, used goods and risks involved, the contractual basis, business strategies and financial status of the parties.

It is very difficult to prove that a transfer price is an artificial price, as perhaps no market price exists in relation to similar transactions and, as such, determining whether or not the rule of independence has been breached is open to dispute.

Recommended reading

C. Herrero Mallol (1999). *Precios de transferencia internacionales*. Pamplona: Aranzadi.

Proposals for solving tax evasion through transfer pricing

In terms of the potential channels to solve the problem, the fight against tax evasion at an international level requires as a priority that the countries' legislation contains regulations on this matter and, in the case of transfer pricing, particularly in relation to transactions conducted electronically.

Moreover, these regulations must grant sufficient powers to the Tax Authority to act subsequent to the transfer prices being set, and should contain precise definitions of types of abuse involved in setting such prices.

All this must be achieved without prejudice to mutual assistance, through the signing of international agreements, which facilitates the exchange of information, fully capitalizing on this opportunity and increasing the use of simultaneous tax inspections. It should also be noted that another strategy that strives to solve this problem involves prior agreements on related-party transactions.

For their part, **DTAs** also contain regulations on the issue of transfer pricing, under which states are obliged to apply corresponding adjustments to eliminate double taxation when the other state has corrected the tax base of its companies[2].

(2) Article 9 of the OECD's DTA model

Transfer pricing and soft law

With respect to transfer pricing, instruments of soft law play an extremely important role. These are non-binding recommendations or guidelines that are not real legal regulations but which sometimes have significant effects similar to legislative rules.

Examples include the guidelines drawn up by the OECD in relation to transfer pricing or the reports of the European Forum on the same matter. These instruments provide a base on which states pass legal regulations on the issue and which are interpreted in accordance with these instruments.

2) Spanish legislation

With respect to the Spanish legislation, Article 18.2 of the Corporate Tax Act lists the circumstances in which the parties are deemed as tax-related. In this way, the legislation strives to cover all of the possibilities of one company's influence over another, whether through personal relations, equity stakes or other channels.

Related-party transactions

Related-party transactions are those conducted between:

1) An entity and its partners or shareholders.

2) An entity and its directors or administrators, except in relation to the remuneration for the performance of their duties.

3) An entity and the spouses or first-, second- or third-degree relatives – whether direct relations or collateral relations related by blood or marriage – of the entity's partners, shareholders, directors or administrators.

4) Two entities that belong to the same group.

5) An entity and the directors or administrators of another entity that belongs to the same group.

6) An entity and the spouses or first-, second- or third-degree relatives – whether direct relations or collateral relations related by blood or marriage – of the partners, shareholders, directors or administrators of another entity that belongs to the same group.

7) An entity and another entity in which the former indirectly owns at least 25% of the latter's capital stock or equity.

8) Two entities in which the same partners or shareholders, or their first-, second- or third-degree relatives – whether direct relations or collateral relations related by blood or marriage – directly or indirectly own at least 25% of the latter's capital stock or equity.

9) An entity resident in Spanish territory and its permanent establishments abroad.

When the relation is between the entity and partners or shareholders, their equity stake has to be 25% or more. Before 2014, this limit was set at 5 or more, or 1% in the case of traded securities. As such, the current regulations have restricted the scope of definition of relations.

Meanwhile, a group is deemed to exist when an entity has or could have control of another or others in accordance with the criteria stipulated in Article 42 of the Commercial Code, regardless of its residence and the obligation to produce annual consolidated accounts.

The criteria for relations in the previous regulations

Up to 2014, there were three other conditions for determining if a relation existed: an entity and the partners or shareholders of another entity, when both entities belonged to the same group; an entity that was non-resident in Spanish territory and its permanent establishments in Spanish territory; and, lastly, two entities that formed part of a group that paid tax under the system reserved for groups of cooperative companies.

To prevent this tax detriment, Article 18.1 of the Corporate Tax Act stipulates that the transaction must be attributed its **normal market value** (as is the case in most states, both at a domestic and treaty level) only in cases in which the related-party transaction would lead to lower tax revenue or a deferral of the tax obligation on the income generated.

Market value

This value is set by non-related individuals or entities under conditions that uphold the principle of free competition.

Example

Company A, controlled by Company B, sells the latter products at cost price.

As a result, Company A does not make any profit, while Company B incurs costs far lower that would be the case if it had to buy at the market price. Its profit is therefore higher than would otherwise be the case. The final outcome is that Company A has transferred the profit to Company B that it would have made by selling at the normal market price, without having had to pay tax on this amount.

The main problem that arises in the application of this regulation is precisely how this **normal market value** is determined, as these transactions tend to take place between companies within the same group for goods and situations for which no comparable market exists or for which no normal market value can be defined, as such market does not exist.

Example

Company A receives a loan for 500,000 euros for Company B, which is an associate. The lender has made losses and the borrower is making profit. For this reason, the two companies agree an interest rate of 10% for the loan, which is double the market value. In accounting terms, the lender records the interest received as income, while the borrower registers the interest paid as expenses.

As both companies, due to the relation that exists between them, have agreed a rate of interest above the market rate, the provisions of Article 18 of the Corporate Tax Act apply, according to which the taxpayer must value the operations performed between related people or entities at the market price.

As a result, the real interest paid comes to 50,000 euros (500,000 x 10%). In contrast, the market rate of interest would come to 25,000 euros (500,000 x 5%).

The value recorded in accounting terms as an expense is 50,000 euros (the agreed interest), while the admissible expenses in fiscal terms only come to 25,000 euros (market interest). Therefore, a positive fiscal adjustment must be made equivalent to the difference. 25,000 euros (50,000 - 25,000).

In an attempt to resolve this problem the Corporate Tax Act[3] applies the **internationally recommended methods** designed for this purpose.

(3) Art. 18.4 of the Corporate Tax Act

Methods for determining the normal market value

In order to establish the normal market value, any of the following methods can be applied, which are approved by the OECD (although its guidelines allow any other method to be applied on the condition that it enables a reasonable result to be obtained, upholding the principle of free competition).

- **Comparable uncontrolled price method**, which involves comparing the price of the goods or services in a transaction between related people or entities with the price of goods or services with identical or similar characteristics in a transaction between independent people or entities under comparable circumstances, making any corrections that may be required to achieve equivalence and take the particular characteristics of the transaction into consideration.

- **Cost plus method**, which consists of taking the purchase value or production cost of the goods services and adding the usual margin applied in identical or similar transactions with independent people or entities or, failing this, the margin that independent people or entities apply in comparable transactions, making any corrections that may be required to achieve equivalence and take the particular characteristics of the transaction into consideration.

- **Resale price method**, which consists of taking the purchase value of the goods services and subtracting the usual margin applied by the reseller in identical or similar transactions with independent people or entities or, failing this, the margin that independent people or entities apply in comparable transactions, making any corrections that may be required to achieve equivalence and take the particular characteristics of the transaction into consideration.

However, in the event that, due to the complexity of the information related to the transactions, the aforementioned methods cannot be applied, the following methods may be used to determine the market value of the operation:

- **Profit split method**, which consists of assigning each related person or entity that jointly conducts one or several transactions the part of the collective profit generated from the transaction or transactions, based on a criterion that adequately reflects the conditions that independent people or entities would have agreed under similar circumstances.

- **Transactional net margin method**, which, in the case of transactions conducted with a related person or entity, involves attributing the net profit, calculated based on costs, sales or most appropriate indicator in view of the characteristics of the transactions, that the taxpayers or, if applicable, third parties, would have obtained in identical or similar transactions conducted between independent people or entities, making any corrections that may be required to achieve equivalence and take the particular characteristics of the transaction into consideration.

The choice of specific valuation method must take into account, among other aspects, the nature of the related-party transaction, the availability of reliable information and the degree of comparability between the related-party transactions and independent transactions.

When it is not possible to apply any of the above methods, other generally accepted valuation methods and techniques can be used, on the condition that they uphold the principle of free competition.

Method	Description	Regulation
Comparable uncontrolled price	Comparable price on the free market	Article 18.4 of the Corporate Tax Act
Cost plus method	Cost price increased by a sector profit margin.	Article 18.4 b of the Corporate Tax Act
Resale price method	Price of resale to a third party	Article 18.4 c of the Corporate Tax Act
Profit split	Distribution of the profit taking into consideration the risk, assets and functions.	Article 18.4 d of the Corporate Tax Act
Transactional net margin method	Net profit	Article 18.4 e of the Corporate Tax Act

The methods in the previous regulations

Before 2014, in the event that, due to the complexity of the information related to the transaction, it was not possible to apply the comparable uncontrolled price method, cost plus method or resale price method, the profit split and transactional net margin methods could be applied instead. As a consequence, the hierarchy of methods to determine the value of related-party transactions contained in the previous regulations has been eliminated.

Meanwhile, the Corporate Tax Act enables taxpayers to request that the Tax Authority determine the value of the transactions conducted between related people or entities prior to executing the transaction. Such requests are to be accompanied by a proposal based on the principle of free competition explaining any potential discrepancies with the normal market value of a particular transaction[4]. This is the case of advanced pricing agreements (APA) or **related-party transaction value prior agreements**. The pricing agreement shall be applied to future related-party transactions and shall be valid for a period no longer than four tax periods following the date of signature. Moreover, as of 2015, the effects of the agreements adopted are extended, for their scope to include transactions in previous tax periods, on the condition that the authority's right to determine the tax obligation through the corresponding settlement has not expired for the period in question or that no final settlement has been made for the transactions that are the object of the request.

(4)Art. 18.9 of the Corporate Tax Act

These are therefore agreements that enable taxpayers to agree the transfer prices in advance with the tax authorities involved. This ensures a greater level of certainty in terms of the tax effects of the transactions in question.

For the purposes of demonstrating that the transactions conducted have been valued at their market value, tax-related individuals or entities must give the tax authorities access to the **specific documentation** stipulated in the regulations, in accordance with the principles of proportionality and adequacy. However, this documentation will have simplified contents in the case of entities or groups with a net turnover lower than 45 million euros. Meanwhile, certain transactions are specified for which the simplified content will not be applicable under any circumstances. Moreover, certain other transactions are listed for which the specific[5] documentation is not required.

(5)Art. 18.3 of the Corporate Tax Act

In addition, **specific pricing rules** are established for transactions between associates and professional companies, adjusted to the economic reality, specifying the need for compliance with the following requirements[6]:

(6)Article 18.6 of the Corporate Tax Act.

- 75% of the entity's revenue must be generated by the performance of professional activities and the entity must be equipped with the appropriate human and material resources to conduct the activity.

- The sum total of the remunerations corresponding to all of the professional associates for the provision of services to the entity must not be lower than 75% of the profit prior to the deduction of the remunerations corresponding to all of the professional associates for the provision of services.

- The sum total of the remunerations corresponding to all of the professional associates must comply with the following requirements: firstly, that the remunerations are determined based on the contribution made by the associates to the smooth operation of the entity, with written notification required of the qualitative and/or quantitative criteria applicable; secondly, the remuneration must not be lower that 1.5 times the average salary of the entity's salaried professionals who fulfil similar functions to the professional associates of the entity. In the absence of these last criteria, the amount of the aforementioned remunerations must not be less than five times the Public Index of Multiple Purpose Income.

In addition, in the case of taxpayers that have a permanent establishment abroad, in the event that it is stipulated as such in an international double taxation treaty that is applicable, it is necessary that incomes obtained from internal transactions conducted with the permanent establishment are included in the taxable base, priced at their market[7] value.

(7)Art. 18.8 of the Corporate Tax Act

The indisputability of the valuation is required in accordance with this specific regulation on related-party transactions with respect to the valuation that may be made in other fields, such as in the case of the value at customs. In specific, the market value for the purposes of Corporate Tax, Personal Income Tax and Non-Resident Income Tax will not have any effects on other taxes, except when there is an express provision to the contrary. Likewise, the value for the purposes of other taxes shall not have any effects on the market value of transactions between related people or entities for the purposes of Corporate Tax, Personal Income Tax and Non-Resident Income Tax, except when there is an express provision to the contrary[8].

(8)Art. 18.14 of the Corporate Tax Act

Other new developments in the current regulation

As of 2015, firstly, Article 18.11 of the Corporate Tax Act stipulates in greater detail the treatment that must be given to the difference between the price agreed for the transfer and the market value in the event that the relation is characterized by the relation between the partners or shareholders of the entity. However, it is stipulated that this criterion shall not apply in the case of asset restitution between the related people or entities under the regulatory conditions established. Such restitution must not be influenced by the existence of income in the parts affected.

Secondly, in the monitoring procedure for related-party transactions stipulated in Article 18.12 of the Corporate Tax Act, the option of requesting a contradictory expert valuation is not permitted

Lastly, the penalty regime regulated in Article 18.13 of the Corporate Tax Act has been amended, becoming less severe.

3. Treaty shopping

Treaty shopping is a phenomenon that occurs whereby entities seek the benefits of the application of the provisions of a DTA despite having no right to this application, because they are not resident in either of the contracting states. It therefore consists of conducting transactions or incorporating companies in another state purely for the purpose of obtaining the benefits of a treaty between this state and a third state, when these benefits would not otherwise be applicable.

The dynamics of the **mechanics** of treaty shopping involve the incorporation of a company (base or conduit company) in a contracting state to redirect the fiscal benefits from the source state to the state of residence, so as to obtain the benefits of the treaty between the source state and the state in which the company is incorporated.

To be specific, treaty shopping occurs when the state of residence has no DTA in place with the source state, or such a treaty does exist but it is less favourable than the DDT between the source state and the state in which the company is incorporated. The incomes to which this usually applies are dividends, interest, royalties and capital gains derived from shares and movable assets. For this reason, it is crucial to know the tax treatment of income in the state in which the company is incorporated.

In general, the state that will be disadvantaged by this practice is the source state, but it may also be the state of residence if the dividend exemption method is established (as the base companies can convert royalties and other incomes into dividends).

Example

Mr. Martínez, resident in a state without a treaty with Spain, incorporates a company in Switzerland, from which he receives income from a Spanish source.

As Spain has a DTA with Switzerland, Mr. Martínez's strategy results in the application of this treaty, which would not have been applicable had he not incorporated the company in Switzerland.

Meanwhile, it should be noted that DTAs often include some type of measure to prevent treaty shopping, so as to not apply to situations not specified in the DTA itself and so taxation at source is not reduced.

The **Commentary to the OECD Model Tax Convention** sets out a series of measures of this type, including the following:

- **Clause excluding non-resident controlled companies**. This clause generally stipulates exclusion from the application of the treaty in the event that the a certain percentage (usually 50%) of the capital of the entity receiving the income is owned by non-residents.

- **Beneficial ownership clause** This clause states that the advantages derived from the application of the DTA can only be applicable if the beneficial owner or ultimate recipient of the advantages is legitimated to do so by the DTA itself. This clause is taken into consideration in the case of dividends, interest and royalties.

- **Clause excluding conduit companies**. In accordance with this clause, DTAs shall only be applicable if the company receiving the income is partly owned or controlled by non-residents and more than 50% of the income is spent on payments to non-resident partners as dividends, interest, royalties or other deductible expenses for the company.

Another practice related to treaty shopping is **rule shopping**, through which the application of a specific precept of the DTA is achieved that differs for the precept that would usually apply (and which involves greater taxation for the source state).

Example

Mr. Pérez, resident in State A, is the owner of a real estate property in State B. There is a DTA in place between the two states. Mr. Pérez decides to set up Company C in State B, which takes ownership of the real estate property.

In accordance with the provisions of the DTA, before the company was incorporated, the income generated by the real estate property could be taxed without limitation in State B, as well as in State A, where the taxpayer is resident.

However, once the company had been incorporated, in the event that the property is let, the income is earned in State B and, when the revenue is transferred to State A (where Mr. Pérez, who controls the company, is resident) in the form of dividends, the limitations stipulated in the DTA apply to the taxation in the source state. The same occurs if the company pays interest on a loan to Mr. Pérez.

4. International tax transparency

4.1. Definition of international tax transparency

The international tax transparency regime (CFC rules) is designed to prevent the effects that arise when taxpayers resident in Spanish territory relocate their capital in companies (that are conduit companies) resident in territories with low taxation for primarily fiscal reasons, so that the incomes generated by this capital are not included in the taxable base, as the company pays the tax, until the company allocates dividends to the resident shareholder or the latter transfers their equity stake (thereby deferring the payment).

Controlled foreign corporations

This occurs in the case of controlled foreign corporations, which have legal personality independent from their shareholders and which are located in a different state from the shareholders' state of residence. In the event that the profits obtained are not distributed, the taxation of the shareholders is excluded and, if the company's state has a lower tax burden, the tax is legally evaded or deferred (until dividends are allocated).

This is a special regime stipulated for Corporate Tax (Article 100 of the Corporate Tax Act) and a taxation regime for incomes in the Personal Income Tax (Article 91 of the Personal Income Tax Act). Both precepts are lengthy and complex.

The reform of this regime

The Corporate Tax Act of 2015 and Article 91 of the Personal Income Tax Act, amended by Law 26/2014, of 27 November, provide for the expansion of this regime and incorporate more assets that generate unearned income.

This consist on the inclusion of certain unearned incomes (dividends, interest and royalties) and positive incomes obtained by non-resident entities as yields for taxpayers subject to Corporate Tax and Personal Income Tax, regardless of whether or not these incomes come from the distribution of profits, on the condition that two essential **requirements** are met, which, in general terms, are as follows:

Taxation of incomes

In this case, we are dealing with a regime of which the basic objective is to tax the Spanish parent company on incomes obtained by the non-resident subsidiary, as if the income had already been distributed.

- The entity in question, by virtue of its residence, must be subject to a favourable tax regime in comparison to the Spanish system
- The resident to which the incomes are attributed must have control over the non-resident entity.

Objective of the international tax transparency regime

By regulating such situations, the aim is to prevent the undesirable consequences of the globalization of the economy, which effectively enables capital to be relocated in countries with low taxation in order to gain fiscal benefits, either through being subject to a less developed tax system or simply by deferring the tax obligation. In any case, the public Spanish Tax Authority may miss out on making any tax revenue at all, at least until the profits are distributed.

In short, the aim is to **combat evasion** of the tax that would be due from a taxpayer who places a company between themselves and the incomes that they would otherwise receive directly.

In the case of international tax transparency, the transparency technique is limited to incomes generated by certain activities or income sources obtained by entities located in territories with low taxation.

Similar measures in our context

The majority of legal regulations at a national level include taxation techniques with effects similar to tax transparency, designed to combat the revenue losses caused by controlled foreign corporations located in tax havens or territories with low taxation.

4.2. The applicable regime

Specifically, entities will be subject to the international tax transparency regime in the event that they meet the following **requirements**:

1) Obviously, the entities in question must be non-resident in Spanish territory and, moreover, they must be resident in territories in which they pay, by way of a tax similar to Spanish Corporate Tax, less than 75% of the amount that would be paid for any of these incomes received if they were taxed in Spain.

2) They must be controlled by taxpayers resident in Spain: a stake of 50% or more of the capital, equity, profits or rights to vote in the non-resident entity in Spain on the closing date of the financial year of this entity.

Criteria for determining control

The criteria for determining control are indicated in point *a* of Article 100 of the Corporate Tax Act, and they are much broader than just a majority stake in the capital stock of the non-resident entity, and refer to the relations listed in Article 18 of the same Act.

The effect of the international tax transparency regime is basically that the **profits** (not losses) **of the non-resident entity will be assigned to the taxpayer resident in Spain** that has a controlling stake in this entity, in proportion to their share of the profits of the transparent entity and, failing this, in line with their stake in the capital stock, equity or rights to vote, taking into account both their direct and indirect participation in all cases. The limitation to this taxation is that the amount taxed cannot exceed the total income of the non-resident entity. The amount of these incomes is calculated in accordance with the regulation on Corporate Tax (Article 100.9 of the Corporate Tax Act) and a single positive income can only be subject to taxation one time (Article 100.10 of the Corporate Tax Act).

Compulsory taxation is stipulated for **all of the positive income** (taken to mean the taxable base on application of the criteria and principles set out in the Corporate Tax Act) obtained abroad by non-resident entities that do not have the corresponding organisation of human and material resources, with the exclusion of just two circumstances:

- That these resources exist in the headquarters of another non-resident entity belonging to the same group.
- That the purpose of the incorporation and operations is for valid economic reasons.

In case in which the non-resident income is not subject to full taxation, the positive incomes derived from the following sources[9] shall be taxed:

(9)Art. 100.3 of the Corporate Tax Act

- Ownership of rural or urban real estate assets (or property rights on such assets) that are subject to economic activities or granted for use to non-resident entities (belonging to the same group of companies as the owner) that are not subject to economic activities.
- Equity stakes in the entities and assignment of equity capitals to third parties, with certain exceptions.
- Capital redemption and insurance operations of which the entity is a beneficiary.
- Intellectual property, technical support, movable property, image rights, letting or subletting businesses or mines unless the special regime is applicable.
- Transfers of real estate assets, equity stakes or capital assignments, capital redemption and insurance operations, and intellectual property, technical support, movable property or image rights.
- Financial derivatives, except when used for the specific coverage of risk in the performance of financial activities.
- Incomes generated from credit, financial or insurance activities or from services provided, directly or indirectly, with individuals or entities resident in Spanish territory and related parties, insofar as tax deductible expenses are determined in such entities.

Inadmissibility of the taxation

These incomes shall not be taxed when they correspond to non-tax deductible expenses in the entities resident in Spain (Sections 4 and 6 of Article 100 of the Corporate Tax Act).

Moreover, such incomes shall not be taxed in the event that the amount of these incomes accounts for less than 15% of total income obtained by the non-resident entity, with the exception of incomes generated from credit, financial or insurance activities or from services provided, which will be fully taxed.

Lastly, if certain requirements are met, it is also stipulated that revenues shall not be taxed when they are generated from equity stakes in any type of entity or the assignment of equity capitals and incomes to third parties, as well as incomes from transfers of real estate assets, equity stakes or capital assignments, capital redemption and insurance operations, and intellectual and industrial property, technical support, movable property or image rights.

Meanwhile, in view of the fact that these incomes are attributed to the resident shareholders of these non-resident entities, the dividends or profit shares for the part corresponding to the positive income that have already been included therein shall not be included in the taxable base of the taxpayers for Spanish taxes (Article 10 of Article 100 of the Corporate Tax Act).

The **tax period** to which incomes must be attributed is the period in which the financial year of the non-resident entity has ended, which must not exceed twelve months[10]. Until 2014, taxpayers were allowed to choose between the aforementioned tax period and the tax period in which the accounts were approved, on the condition that the latter period had not ended more than six months previously.

(10)Art. 100.8 of the Corporate Tax Act

Once the incomes have been attributed to a tax period, in accordance with Article 100.11 of the Corporate Tax Act, shareholders can **deduct from their total tax liability** or their payable tax amount (according to Article 91.10 of the Personal Income Tax Act) the taxes that are identical or similar to Corporate Tax that have effectively been paid, with respect to the part that corresponds to the positive income included in the taxable base, as well as any taxes effectively paid abroad on the distribution of dividends or profit shares, whether this is in accordance with an agreement to avoid double taxation or the domestic legislation of the country or territory in question, with respect to the part that corresponds to the positive income previously included in the taxable base. These deductions may not exceed the gross tax payable to be paid in Spain for the positive income included in the taxable base.

Tax havens

Under no circumstance shall taxes paid in countries or territories classified in the legislation as tax havens be deducted.

Example

Company A, resident in Spanish territory and subject to Corporate Tax, has a 50% stake in the capital of Company B, resident in Switzerland. The incomes earned by Company B come from bearer bonds, the rent on a real estate property and dividends. The taxes paid by Company B in Switzerland for a tax similar to Corporate Tax amount to 70,000 euros.

Company B meets all of the criteria for being subject to the international tax transparency regime as, on its own, Company A owns a 50% stake in its capital.

All of the income obtained by Company B are attributable to Company A (Article 100.2, Sections *a* and *b* of the Corporate Tax Act) for half of their total amount, in proportion to its stake in the capital of Company B. As such, the Swiss tax that is deductible from its total tax liability would be 35,700 euros.

In terms of **formal obligations** that are borne by resident shareholders that have included these incomes in their taxable base, together with the corresponding income tax statement (Personal income Tax or Corporate Tax), the following information about the transparent entity must be included: name or company name, registered address, list of administrators and their registered address, balance sheet, profit and loss statement, annual report, amount of positive income that must be included in the taxable base, and proof of the taxes paid on the positive income that must be included in the taxable[11] base.

(11)Art. 100.13 of the Corporate Tax Act.

Lastly, it should be noted that this regime may present obstacles that are incompatible with the freedom of establishment stipulated in Article 43 of the Treaty on the Functioning of the EU, as construed by the Court of Justice of the EU (*Cadbury Schweppes* ruling, of 9 December, C-196/04) with respect to the scope of this freedom and the direct taxation regulations of the Member states of the European Union. For this reason, international tax transparency **is not applicable** in the event that the non-resident entity is, at the same time, **resident in a Member State of the European Union**, (unless they are resident in a territory classified as a tax haven). This depends upon their ability to demonstrate that the purpose of the incorporation and operations of the entity is for valid economic reasons and that it conducts business activities, or that it is a collective investment institution regulated by the EU[12] regulation.

(12)Art. 100.16 of the Corporate Tax Act

5. Tax havens

5.1. Concept and features

One of the taxation problems associated with globalization is the proliferation of commercial transactions with or by people resident in territories classified as tax havens. The problem is particularly linked to tax evasion and money laundering, with which it is often connected.

As explained below, there is a series of taxation measures designed to combat this type of tax evasion, which developed countries have enshrined in their legislation.

> The existence of **tax havens** is based on reasons that are historical, related to fiscal competition or even simply territorial. The tax regime in all of these countries or territories is characterized by favourable fiscal treatment – or no taxation at all – for certain operations. As a result, they attract foreign capital. This situation has led to the development of anti-tax haven legislation by industrialized countries.

The main **characteristics** of a tax haven are as follows:

Recommended reading

A. Maldonado García-Verdugo (2002). "Nueva posición de la OCDE en materia de paraísos fiscales". *Documentos del Instituto de Estudios Fiscales* (no. 2).

- Low or no direct taxation, which may take various forms: no income tax, special tax incentives for foreign companies that set up in their territories, or territorial taxation systems that exempt all incomes generated from foreign sources.

- The existence of considerably flexible commercial and financial legislation.

- Protection of banking and commercial secrecy.

- Absence of exchange controls.

- Insignificant or non-existent network of double taxation treaties.

Tax havens are not only used by legal entities (with is the most common case, as they have a great level of flexibility for restructuring, planning and performance of their financial activities), but also by natural persons. In the case of the latter, the objective is to achieve a situation of no or very low taxation on income, inheritance and wealth, or perhaps, through the principle of territoriality, to limit the degree to with their income is subject to tax to the rates applicable in tax havens, which are generally negligible or non-existent. In the case of legal entities, the objectives include the exemption of their incomes, tax deferral, reclassification of incomes, and the reduction of the taxable bases of the resident entities.

The profile of natural persons

The profile of natural persons that use tax havens is an individual with extremely high levels of income and wealth, such as elite sportspeople, international artistes and shareholders in large companies.

The benefit sought by legal entities

As indicated above, the different objectives sought by legal entities when they use a tax haven are basically the following:

- Tax exemption for incomes through the use of opaque corporate structures that enable incomes to be transferred from states with high taxation to states or territories with low taxation so these incomes are not subject to taxation in the state of residence.
- Tax deferral, as the incomes are not subject to taxation until they are distributed to taxpayers resident in countries with high taxation.
- Reclassification of income in order to benefit from lower tax rates, exemptions or the application of some type of reduction coefficient.
- Reduction of taxable bases, through the use of opaque structures by entities resident in countries with high taxation, through the deduction of interest, royalties or services provided to other related entities resident in territories classified as tax havens.

However, both the international bodies and institutions and the domestic legislation of states respond to this situation by adopting an ever-growing series of anti-tax haven measures, which make the use of tax havens increasingly less attractive for companies.

Within this context, the OECD regularly publishes a list of tax havens, giving the territories an ultimatum to reform their taxation systems or risk facing actions for non-compliance. The OECD accuses tax havens of practising **harmful tax competition** by attracting individuals and companies with the aim of evading taxes in their own countries.

Tax havens and non-cooperative jurisdictions

By the OECD's definition, a tax haven is a territory with low taxation as well as a lack of transparency and exchange of information.

Moreover, it defines non-cooperative jurisdictions as territories in which, despite not having low taxation, there are low levels of transparency and exchange of information.

This international organisation gives the countries or territories the opportunity to decide "whether or not they wish to work with the OECD to eliminate the harmful features of their tax regimes", giving them a deadline by which to reform their taxation systems. The defensive measures indicated include withholding economic aid from these countries or territories. In addition, a model of a tax information exchange agreement has been approved.

Black, grey and white lists

On this matter, the OECD drafts a black list, with states or territories that have never made a commitment to respect international regulations on tax matters (on which no states currently appear), a grey list, with states or territories that have pledged to respect the OECD regulations but have not yet applied them, and lastly, a white list, including all of the jurisdictions that comply with the international standards on the exchange of information.

5.2. Spain's definition and list of tax havens

In relation to the Spanish anti-tax haven taxation measures, it should also be noted that Spain has gradually incorporated a series of measures to combat tax havens in its legislation, with a notable example being the approval of Royal Decree 1080/1991, of 5 July, which includes a **list** of the countries and territories that it classifies as tax havens. This black list generally contains territories with low or no taxation or which do not exchange information.

Closed list

This is a list that, on the one hand, provides a high degree of legal security but which, on the other hand, is excessively rigid.

List of tax havens		
1. Principality of Andorra [10]	17. The Dominican Republic	33. Turks and Caicos Islands
2. Netherlands Antilles [4] [11]	18. Granada	34. Republic of Vanuatu
3. Aruba [5]	19. Fiji	35. British Virgin Islands
4. Emirate of Bahrain	20. Guernsey and Jersey (Channel Islands)	36. United States Virgin Islands
5. Sultanate of Brunei	21. Jamaica [6] [7]	37. Hashemite Kingdom of Jordan
6. Republic of Cyprus [18]	22. Republic of Malta [3]	38. Lebanese Republic
7. United Arab Emirates	23. Falkland Islands	39. Republic of Liberia
8. Gibraltar	24. Isle of Man	40. Principality of Liechtenstein
9. Hong Kong [17]	25. Mariana Islands	41. Grand Duchy of Luxembourg, with respect to income earned by companies indicated in Paragraph 1 of the Protocol annexed to the Treaty, to avoid double taxation, dated 3 June 1986[8].
10. Anguilla	26. Mauritius	42. Macau
11. Antigua and Barbuda	27. Montserrat	43. Principality of Monaco
12. The Bahamas ([15]	28. Republic of Nauru	44. Sultanate of Oman
13. Barbados [16]	29. Solomon Islands	45. Republic of Panama [13]

Source: Document - *Taxation of non-residents.* AEAT website

List of tax havens		
14. Bermuda	30. Saint Vincent and the Grenadines	46. Republic of San Marino (12)
15. Cayman Islands	31. Saint Lucia	47. Republic of the Seychelles
16. Cook Islands	32. Republic of Trinidad and Tobago (9)	48. Republic of Singapore(14)

Source: Document - *Taxation of non-residents.* AEAT website

(1) The classification of tax haven shall be given to countries and territories that are specified as such under the regulations. Until classified otherwise, the classification of tax haven shall be given to countries and territories stipulated in Article 1 of Royal Decree 1080/1991, of 5 July, which specifies the countries and territories that are subject to Article 2, Section 3, Point 4 of Law 17/1991, of 27th May, regarding Emergency Fiscal Measures, and Article 62 of Law 31/1990, of 27th December, regarding the General State Budgets for 1991 (second transitional provision of Law 36/2006).

As of 2 February 2003, the date on which Royal Decree 116/2003, of 31 January, came into force, a provision was added to Royal Decree 1080/1991 that stipulates that countries or territories shall no longer be considered tax havens if they sign a international double taxation convention with Spain with a clause on the exchange of information or an agreement to exchange information on tax matters expressly stating that they no longer shall be considered as such, as of the moment at which these treaties or agreements take effect.

The countries or territories indicated in the preceding paragraph shall once again be considered tax havens from the moment that these agreements cease to take effect.

In view of the preceding paragraphs, the following territories have been removed for the original list: Principality of Andorra, Netherlands Antilles, Aruba, Republic of Cyprus, United Arab Emirates, Hong Kong, the Bahamas, Barbados, Jamaica, Republic of Malta, Republic of Trinidad and Tobago, Grand Duchy of Luxembourg, Republic of Panama, Republic of San Marino and Republic of Singapore.

As a consequence, the current list of territories, taking into account the amendments resulting from the provisions of Royal Decree 116/2003, shall continue to apply until a new list is approved.

As of 1 January 2015, the list of countries and territories classified as tax havens can be updated on the basis of the following criteria:

a) The existence of an international double taxation treaty with such a country or territory with a clause on the exchange of information or an agreement to exchange information on tax matters, or this country or territory being a signatory of the Convention on Mutual Administrative Assistance in Tax Matters of the OECD and European Council, amended by Protocol 2010, that is currently in force.

b) Lack of an effective exchange of tax information.

c) The results of the peer assessments conducted by the Global Forum on Transparency and Exchange of Information for Tax Purposes.

As a consequence, as of the date that this amendment came into force, the updating of list shall not be automatic, but rather it must be expressly updated and, to this end, the aforementioned criteria shall be taken into consideration.

(First Additional Provision of Law 36/2006, of 29 November 2006, on Tax Fraud Prevention Measures).

(2) The treaty between Spain and the United Arab Emirates to avoid double taxation came into force on 02/04/07 (see Annex 1).

(3) The treaty between Spain and the Malta to avoid double taxation came into force on 12/09/06 (see Annex 1)

(4) Since 27/01/10 (date on which the Agreement on the Exchange of Information on Tax Matters came into force - BOE 24/11/09), this territory is no longer classified as a tax haven.

(5) Since 27/01/10 (date on which the Agreement on the Exchange of Information on Tax Matters came into force - BOE 24/11/09), this territory is no longer classified as a tax haven.

(6) The treaty between Spain and Jamaica to avoid double taxation came into force on 16/05/09 (see Annex 1).

(7) The companies indicated in Paragraph A of Section V of the Treaty Protocol are exempt from this and the effects of the application of the First Additional Provision of Law 36/2006 on Tax Fraud Prevention Measures.

(8) Since 16/07/10 (date on which the Treaty Amendment Protocol came into effect - BOE 31/05/10), this territory is no longer classified as a tax haven.

(9) The treaty between Spain and Trinidad and Tobago to avoid double taxation came into force on 28/12/09 (see Annex 1).

(10) Since 10/02/11 (date on which the Agreement on the Exchange of Information on Tax Matters came into force - BOE 23/11/10), this territory is no longer classified as a tax haven.

(11) As of 10 October 2010 (date of the dissolution of the Netherlands Antilles), Curaçao and Saint Martin became autonomous states of the Kingdom of the Netherlands. The remaining islands (Bonaire, Sint Eustatius and Saba) became part of the Netherlands. In the case of Curaçao and Saint Martin, the agreement on the exchange of information signed with the Netherlands Antilles applies, while, in the case of the of the three islands, the DTA signed with the Netherlands applies.

(12) Since 02/08/11 (date on which the Agreement on the Exchange of Information on Tax Matters came into force - BOE 06/06/11), this territory is no longer classified as a tax haven.

(13) The treaty between Spain and Panama to avoid double taxation came into force on 25/07/11 (see Annex 1).

(14) Since 01/01/13 (date on which the Treaty came into effect - BOE 11/01/12), this territory is no longer classified as a tax haven.

(15) Since 17/08/11 (date on which the Agreement on the Exchange of Information on Tax Matters came into force - BOE 15/07/11), this territory is no longer classified as a tax haven.

(16) Since 14/10/11 (date on which the treaty between Spain and Barbados to avoid double taxation came into force - BOE 14/09/11), this territory is no longer classified as a tax haven.

(17) Since 01/04/13 (date on which the Treaty came into effect - BOE 14/04/12), this territory is no longer classified as a tax haven.

(18) Since 28/05/14 (date on which the Treaty came into effect - BOE 26/05/14), this territory is no longer classified as a tax haven.

However, in the event that they sign an agreement to exchange information on tax matters or a double taxation treaty with a clause on the exchange of information, these countries or territories will no longer be considered as tax haven (Article 2 of Royal Decree 1080/1991).

Example

The government of Saint Vincent and the Grenadines contacts a tax consultant to find out the effects of signing an agreement on the exchange of tax information with Spain.

As it appears on the list in Article 1 of Royal Decree 1080/1991, Saint Vincent and the Grenadines is classified as a tax haven by Spain. However, in the event that it signed an agreement of this type with Spain, it would no longer be classified as such by the Spanish Tax Authorities.

There are currently several jurisdictions that are no longer considered tax havens by the Spanish authorities as a result of signing one of these instruments (this is the case of Andorra, the United Arab Emirates, Jamaica and the Netherlands Antilles, among others).

Article 25 of the Treaty between Spain and Australia

By way of an example, there follows a transcription of Article 25 (related to the Exchange of Information) of the Treaty between Spain and Australia to avoid double taxation and tax evasion in relation to taxes on income and capital, signed on 24 March 1992:

"1) The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes covered by the Convention, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Article 1. Any information received by the competent authority of a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, and the determination of appeals in relation to the taxes covered by the Convention. Such persons or authorities shall use the information only for such purposes.

2) In no case shall the provisions of paragraph 1 of this Article be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State.

b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State.

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy."

Alongside the concept of *tax haven*, the categories of *territories with no taxation* and *effective exchange of information* must be taken into consideration. These are different concepts but are designed for the same purpose: the fight against international tax fraud. These concepts were introduced in the First Additional Provision of Law 36/2006, of 29 November 2006, on Tax Fraud Prevention Measures, amended by Law 26/2014, of 27th November. Therefore, there are three categories created under Spanish legislation to counteract the use of opaque jurisdictions or jurisdictions with low taxation, in view of the fact that these two categories have been added to the traditional concept of tax havens.

In accordance with this provision, the classification of **tax haven** shall be given to countries and territories that are specified as such under the regulations. However, the list of countries or territories classified as such can be **updated** in accordance with the following criteria:

- A country or territory shall no longer be considered a tax haven when they sign a international double taxation treaty with a clause on the exchange of tax information or an agreement to exchange information on tax matters, or when they are a signatory of the Convention on Mutual Administrative Assistance in Tax Matters of the OECD and European Council, amended by Protocol 2010, that is currently in force, as of the moment at which these treaties or agreements take effect. However, from the moment that these treaties or agreements cease to apply, the countries or territories in question shall once again be considered tax havens.

- Lack of an effective exchange of tax information.

- The results of the peer assessments conducted by the Global Forum on Transparency and Exchange of Information for Tax Purposes.

To this end, the Government has the power to update this list of countries and territories classified as tax havens.

Meanwhile, a situation of **no taxation** is deemed to exist when the country or territory in question does not have a tax in place that is identical or similar to Personal Income Tax, Corporate Tax or Non-Resident Income Tax, as applicable. In this respect, an identical or similar tax is understood to mean a tax for the purpose of taxing income, albeit partially, regardless of whether the object of the tax is income, revenue or any other indicator thereof.

Calculation of the tax

It should be noted that there is no requirement that the identical or similar tax is calculated taking into account the corresponding aspects of the tax in the same way as Spain.

Moreover, there is no closed list of jurisdictions with no taxation.

Furthermore, in the case of Personal Income Tax, Social Security contributions shall be considered in this way under the conditions established by the regulations. In addition, it shall be deemed that an identical or similar tax is applied when the country or territory in question has signed a international double taxation treaty with Spain that is currently in force, with the characteristics stipulated therein.

Lastly, an **effective exchange of tax information** is deemed to exist with countries or territories with which Spain has signed a international double taxation treaty with a clause of the exchange of information, on the condition that this treaty does not expressly stipulate that the level of the exchange of information is insufficient for the purposes of this provision or an agreement to exchange information on tax matters, or which is a signatory of the Convention on Mutual Administrative Assistance in Tax Matters of the OECD and European Council, amended by Protocol 2010. However, regulations may be established to stipulate the conditions under which, due to limitations in terms of the exchange of information, the effective exchange of tax information is not deemed to exist.

Countries of the EU and the European Economic Area with effective exchange of tax information in place.

EU countries	**Other EEA countries with effective exchange of tax information in place (4)**
Austria	Iceland
Belgium	Norway
Bulgaria (2)	
Croatia (3)	
Cyprus (1)	
Czech Republic (1)	
Denmark	
Estonia (1)	
Finland	
France	
Germany	
Greece	
Hungary (1)	
Ireland	
Italy	
Latvia (1)	
Lithuania (1)	
Luxembourg	
Malta (1)	
Netherlands	
Poland (1)	
Portugal	
Slovakia (1)	
Slovenia (1)	
Spain	
United Kingdom	

Source: Document - *Taxation of non-residents*. AEAT website

EU countries	Other EEA countries with effective exchange of tax information in place (4)
Romania (2)	
Sweden	

(1) European Union Member States since 1 May 2004.
(2) European Union Member States since 1 January 2007.
(3) European Union Member States since 1 July 2013.
(4) The EEA consists of the members of the European Union, plus Iceland, Norway and Liechtenstein.
An effective exchange of tax information exists with countries and territories that are not considered tax havens and with which one of the following applies:

- An international double taxation treaty with a clause on the exchange of information, on the condition that this treaty does not expressly stipulate that the level of the exchange of information is insufficient for the purposes of this provision.
- An agreement to exchange information on tax matters.
- The Convention on Mutual Administrative Assistance in Tax Matters of the OECD and European Council, amended by Protocol 2010.

Liechtenstein is considered a tax haven and, moreover, Spain does not have any international double taxation treaty nor agreement to exchange information in place with Liechtenstein, and the state is not a signatory of the mutual administrative assistance agreement. Therefore, despite being a member of the EEA, it is excluded from the list.

Source: Document - *Taxation of non-residents*. AEAT website

5.3. Spanish anti-tax haven fiscal measures

Within the field of taxation on income, in the Spanish national legislation, there are various anti-tax haven regulations in place to prevent the relocation of income to this type of jurisdiction. As well as measures related to residence, other provisions prevent taking advantage of certain tax incentives, deductions or exemptions for international double taxation with respect to incomes generated in tax havens.

From an analysis of the regulatory framework of Personal Income Tax, Corporate Tax and Non-Resident Income Tax, the following **anti-tax haven provisions** can be identified:

1) Personal Income Tax

- The Personal Income Tax Act[13] stipulates that, in the case of countries and territories classified as tax havens, the Tax Authority can demand **proof that they reside** one hundred and eighty three days of the calendar year in the country or territory.

(13) Art. 9.1 LIRPF

- In addition, **natural persons of Spanish nationality** that demonstrate their residence for tax purposes in a country or territory classified as a tax haven shall not lose the status of taxpayer. This regulation applies to the tax period in which the change in residence takes place and the following four tax periods[14].

(14) Art. 8.2 LIRPF

- The **exemption for income derived from employment performed abroad** shall not be applicable when the territory in which the work is performed is a tax haven (however, this exemption does apply when the country or territory in question has signed a DTA with Spain containing an exchange of information[15] clause).

(15)Art. 7 LIRPF

- Certain limitations[16] are stipulated on the application of the **international tax transparency scheme**.

(16)Art. 91 LIRPF

- It shall not be possible to deduct taxes paid in countries or territories considered to be tax havens in the case of **imputation of income from the assignment of image rights**[17].

(17)Art. 92.4 LIRPF

- Lastly, the existence of an income tax regime is stipulated for **partners or shareholders in collective investment institutions** established in countries or territories considered to be **tax havens**[18].

(18)Art. 95 LIRPF

2) Non-resident income tax

- In the case of a depositary or administrator of assets or rights not assigned to a permanent establishment and belonging to a person or entity resident in a tax haven, the actions of the Tax Authority can be addressed to the manager directly.

- Meanwhile, there are also **exemption exclusion** measures in relation to interest, capital gains, public debt and dividends[19].

(19)Art. 9.3 TRLIRNR

Exclusion from certain exemptions

Article 14 of the Consolidated Text of the Non-Resident Income Tax Act, after stipulating in Section 1 the exemption of incomes derived from interest and other revenue generated from the assignment of equity capitals to third parties, as well as capital gains derived from movable assets obtained by residents in other EU Member States, without a permanent establishment (point *c*), and doing the same with respect to returns on public debt obtained without a permanent establishment (point *d*) and incomes derived from securities issued in Spain by non-resident natural persons or entities without a permanent establishment (point *e*), goes on to establish, in Section 2, that such exemptions shall not be applicable in the case of returns and capital gains obtained through countries and territories that are classified under the legislation as tax havens.

Moreover the exemption stipulated in point *h* of the aforementioned Article 14 of the Redrafted Text of the Non-Resident Income Tax Act (in reference to the profits distributed by affiliated companies resident in Spanish territory to their parent companies resident in other EU Member States) does not apply in the event that the parent company's residence for tax purposes is in a country or territory that is classified under the legislation as a tax haven.

- The regulations governing the tax stipulate a supplementary taxation of 19% on income obtained by permanent establishments that are transferred abroad. This tax shall not apply when the permanent establishments correspond to entities with residence for tax purposes in another EU Member State, except in the case of a country or territory considered

(20)Art. 19 Sections 2 and 3 TRLIRNR

as a tax haven, and neither will it apply in a state that has signed an DTA with Spain, provided that there exists reciprocal treatment[20].

- A rule is established for the transfer pricing to calculate the taxable base in Article 13.1.i.3 of the Consolidated Text of the Non-Resident Income Tax Act in the case of capital gains arising from the transfer of rights or equity stakes in entities resident in countries or territories with which no effective exchange of information exists. In such cases, the transfer price shall be determined proportionally with respect to the market value, at the time of transfer, of the real estate assets located in Spanish territory or the rights of use of these assets[21].

(21)Art. 24.4 TRLIRNR

- In addition, Non-Resident Income Tax shall apply to real estate assets located in Spain in the case of capital gains as indicated in Article 13.1.i.3 of the Consolidated Text of the Non-Resident Income Tax Act arising from the transfer of rights or equity stakes in entities resident in countries or territories with which no effective exchange of information[22] exists.

(22)Art. 25.3 TRLIRNR

- Lastly, the optional regime shall not apply to residents in other EU Member States[23].

(23)Art. 46.7 TRLIRNR

3) Corporate Tax

- With respect to the **criteria for determining residence**, in the case of entities established in a country or territory with no taxation or in a tax haven, the Tax Authority can consider that such entities are resident in Spanish territory when the entity's main assets directly or indirectly consist of goods located in or rights that are fulfilled or exercised in Spanish territory, or in the event that the entity's main activity is conducted in Spanish territory. An exception to this is when the entity proves that its effective management or direction takes place in the country or territory in question, and that the purpose of the incorporation and operations of the entity is for valid financial and business reasons that are significantly different from simply managing securities or other assets[24].

(24)Art. 8.1 of the Corporate Tax Act.

- The special regime for **mergers** and **demergers** stipulated in the Corporate Tax Act shall not apply. In this respect, it is stipulated that the revenues obtained from transactions involving entities that are resident or established in countries or territories classified as tax havens[25] or revenues obtained through them must be included in the taxable base of Income Tax or Corporate Tax.

(25)Art. 81.4 of the Corporate Tax Act.

- Likewise, neither shall the **special regime for security-based swaps** apply to revenue obtained from transactions involving entities that are resident or established in tax havens or obtained through them[26].

(26)Art. 80.5 of the Corporate Tax Act.

- This results in a far more strict treatment as far as **international tax transparency**[27] is concerned, and no extension in the liberalization measures in the exchange control regulations.

(27)Art. 100 Sections 4 and 11 of the Corporate Tax Act.

- The same occurs in the case of the **Special Regime for Foreign Security Holding Companies**, under which its application will be restricted in the event that the recipient of the income is resident in a tax haven[28].

(28)Art. 108.4 of the Corporate Tax Act.

- At the same time, taxpayers subject to Corporate Tax that have stakes in **collective investment institutions** established in tax havens[29] must include in their taxable bases the difference between the net asset value of the stake on the closing day of the tax period and its purchase value; it shall be assumed that this difference is 15% of the purchase price, unless demonstrated otherwise.
  Profits distributed by the collective investment institution have a double effect: they are not included in the taxable base of the taxpayer and they reduce the purchase value of the equity stake. Such profits do not entitle the taxpayer to apply deductions for double taxation. The Personal Income Tax regulations[30] establish a similar provision for natural persons.

(29)Art. 54 of the Corporate Tax Act.

(30)Art. 95 LIRPF

- Meanwhile, there is a **special pricing regime** applicable to transactions between resident entities that are taxpayers subject to Corporate Tax and entities that are non-resident in Spain but established in territories classified as tax havens[31].

(31)Art. 19.2 of the Corporate Tax Act.

Pricing of transactions in line with their normal market price

By virtue of this rule, the Tax Authority can quantify such transactions according to their normal market price.

There is no equivalent rule applicable to resident taxpayers subject to Personal Income Tax. However, Article 19.2 of the Corporate Tax Act, by referral from Article 28.1 of the Personal Income Tax Act, is applicable to taxpayers subject to the latter in order to determine the net yield of their economic activity.

Example

Company A, resident in Spain, sells goods to Company B, with fiscal domicile in the Seychelles, for the amount of 200,000 euros.

The Seychelles meet Spain's criteria for tax havens, so under the provision of Article 19.2 of the Corporate Tax Act – in terms of how much Corporate Tax Company A should pay – the Spanish Tax Authority can quantify the transaction at its normal market value if it does not consider 200,000 euros to be the normal market value, as this figure would lead to lower tax revenue in Spain than would be generated if this market value were applied, or to a deferral of the tax.

- It must also be taken into consideration that the service **expenses** incurred in transactions carried out with people or entities resident in tax havens or paid through residents in these tax havens are not deductible, except in the event that the taxpayer proves that the expenses incurred relate to an effectively performed operation or transaction[32].

(32)Art. 15 g) of the Corporate Tax Act

- The application of the **exemption to avoid international double taxation** excludes dividends and income from foreign sources derived from the transfer of securities representing equity stakes in entities that are non-resident in Spanish territory, when the entity of the equity stake in question is resident in a tax haven[33] (except if they are resident in an EU Member State and the taxpayer can demonstrate that the purpose of the incorporation and operations of the entity is for valid economic reasons and that it conducts business activities).

(33)Art. 21.9 of the Corporate Tax Act.

- Moreover, the **exemption of certain incomes obtained abroad through a permanent establishment** is not applicable when the territory in question is a tax haven, except in the event that it is also a Member State of the European Union and that the taxpayer can demonstrate that the purpose of the incorporation and operations of the entity is for valid economic reasons and that it conducts financial[34] activities.

(34)Art. 22.7 of the Corporate Tax Act.

- In the same way, the **reduction in revenue from certain intangible assets** is not applicable if the assignee is resident in a country with no taxation or which is considered to be a tax haven, unless this country is a Member State of the European Union and the taxpayer can demonstrate that the transaction was performed for valid economic reasons and that they conduct economic[35] activities.

(35)Art. 23 c) of the Corporate Tax Act

- Neither shall be applied the **exemption for venture capital entities** in the case of residents in a tax haven[36] (except under certain circumstances).

(36)Art. 50 Sections 5 and 6 of the Corporate Tax Act.

- Lastly, there is an **obligation to document** transactions with related individuals or entities resident in tax havens[37].

(37)Art. 18.3 of the Corporate Tax Act.

Activities

Case studies

1. Indicate which countries or territories included on the Spanish black list of tax havens are no longer classified as such by the Spanish authorities. Specify why, from when and for how long they have lost their status as tax havens.

2. A company domiciled in Barcelona produces and records cinema films and audiovisual material in general. Suddenly, in 2014 and 2015, the company declares that it has paid significant amounts of money as royalties (3,500,000 and 4,125,000 euros, respectively) to three companies domiciled in Budapest (Hungary) without any withholdings on this income being made. The Spanish Tax Inspectorate investigates and considers that this is a case of a transaction designed to benefit from advantageous treatment under the Treaty between Spain and Hungary in this particular section, and that the Hungarian companies are conduits. On what fiscal basis could the Inspectorate propose the regularization of the withholdings for the unpaid Non-Resident Income Tax?

Self-evaluation

1. Which of the following countries or territories is considered to be a tax haven by the Spanish authorities?

a) Andorra.
b) Gibraltar.
c) Switzerland.

2. The company Opel, with residence for tax purposes in Germany, has transferred the technology to Spain needed to manufacture the Opel Corsa in Spain. The price of the transaction is below the market price. How should this transaction be valued for tax purposes?

a) At the price agreed between the two parties (i.e. the price for which the transaction has effectively been made).
b) At the price that would have been agreed by two independent entities under conditions of free competition.
c) At its book value.

3. The expression *tax haven*, as certain territories with low taxation and low information transparency are known,…

a) is only used from a conventional point of view.
b) comes from the fact that the majority of these territories are islands located in the tropics.
c) has nothing to do with the original meaning in English.

4. Transactions between related companies are governed by the tax regulations of the different countries…

a) due to problems with transparency that would arise otherwise.
b) due to the almost certain involvement of an entity based in a tax haven
c) due to the risk of moving the taxable bases to the entities with the most advantageous taxation system.

5. The Republic of Cyprus…

a) would automatically no longer be considered a tax haven from the moment it joined the OECD.
b) is considered a tax haven under the criteria of Spanish legislation.
c) is considered to be a tax haven only for certain types of equity income.

6. An example of an anti-tax haven measure is…

a) exclusion from the exemption regime of dividends and income derived from transferring shares in entities that are non-resident for the purpose of Corporate Tax.
b) exclusion from the application of the exemption regime for certain incomes obtained abroad through a permanent establishment in respect to Corporate Tax.
c) Both answers are correct.

7. The tax transparency regime…

a) does not apply to EU residents, except those living in a tax haven.
b) does not apply to EU residents.
c) applies to EU residents.

8. The Corporate Tax Act stipulates the following methods for valuing transfer prices:

a) Comparable uncontrolled price and net profit of the set of transactions.
b) Resale price to a third party and net profit of the set of transactions.
c) Both answers are incorrect.

9. International tax planning…

a) is an illegal activity.
b) uses different strategies designed to mitigate tax obligations.
c) is only based on DTAs.

10. To avoid treat shopping, the Commentary to the OECD Model Tax Convention outlines the following methods:

a) A clause excluding non-resident controlled companies.
b) A real investment clause.
c) A clause on rule shopping.

Answer key

Practical cases

1. The tax havens that appeared on the black list contained in Royal Decree 1080/1991, of 5 July, may lose their classification as tax havens if they sign one of the following two documents with Spain: a) an agreement to exchange information on tax matters, b) a double taxation treaty with a clause on the exchange of information (Article 2 of RD 1080/1991 and Additional Provision 1 of Law 36/2006, of 29 November). In accordance with these criteria, territories would no longer be considered tax havens from the moment at which these treaties or agreements take effect, and they may once again be considered as such if these instruments ceased to take effect.

There are several tax havens that have signed this type of agreement or treaty with Spain and are therefore no longer considered as such as of the date these agreements have taken effect. There follows a list of the countries and territories on the black list that have signed such treaties, with the date in which they came into effect in brackets.

Double taxation treaties with a clause on the exchange of information: Barbados (14/10/11), United Arab Emirates (02/04/07), Jamaica (16/05/09), Luxembourg (16/07/10), Malta (12/09/06), Panama (25/07/11), Singapore (02/02/12) and Trinidad and Tobago (28/12/09).

Agreements to exchange information on tax matters in which it is expressly stated that the states or territories in question will no longer be classified as tax havens. Andorra (10/2/11), Netherlands Antilles (27/01/10), Aruba (27/01/10), Bahamas (17/08/11) and San Marino (02/08/11).

2. Once the the results of the evaluations conducted have been considered, it can be concluded whether or not the Hungarian entities are the beneficial owners of the royalties paid, or if these entities are being used by residents in other states for the sole purpose of taking advantage of the beneficial treatment that the Treaty grants these incomes.

In effect, limiting the taxation at source is justified insofar as the recipient resident in the other state is the beneficial owner of this income. Otherwise, it is considered that the source state is not under obligation to waive their right to tax this income and limit its fiscal capacity. In summary, the exemption only applied when the beneficial owner of the incomes generated in the source state is not the recipient of these incomes, so the aforementioned source state retains the right to tax the royalties generated in its territory without limitation in accordance with its legislation. This is the legal basis that would underpin the proposal for supervisory regularization.

The concept of *beneficial owner* is not defined in the agreements signed by Spain, but it is defined in the Commentary to the OECD Model Tax Convention (specifically in Comment 4 of Article 12).

Spanish courts have cited and recognized this concept, particularly through the National High Court, the rulings of which of 7th October 2004 and, even more so, 18 July 2006 are particularly interesting in this respect. These rulings state that the figure of the beneficial owner shall only exist when the incomes paid to a non-resident are received by somebody who is the statutory owner (trustee) but not the real owner (trustor). Such conduct falls within the framework of treaty shopping, the objective of which is to mitigate or eliminate tax obligations in the source state through an agreement which is, in principle, inapplicable. In order to apply this, an intermediary is usually involved in the state that has signed an agreement with the source state (in this case, Spain) that was previously considered more favourable (in this case, the Treaty with Hungary). The intermediary may simply be a person acting on behalf of the true owner of the income or perhaps a company to which the ownership of the income generated in the source state is formally and substantially attributed.

However, as acknowledged in an OECD report in 1986 that was cited for the second of the aforementioned High Court rulings, "in practice, it is very difficult for the source state to demonstrate that the intermediary company is not the beneficial owner. The fact that the main purpose of the intermediary company is holding assets or other rights is not sufficient in itself to classify the company as a mere intermediary. However, the fact that this is its main purpose may indicate that a more in-depth analysis of the company is required. In any case, this analysis may be too burdensome for the source state. Moreover, in certain cases, the state of residence of the intermediary company may not have sufficient information regarding the shareholders of the company, other stakeholders or the company's decision-making process."

In any case, analysis of the evidentiary process that has been gathered will be crucial, taking into account the validity of using circumstantial evidence.

Self-evaluation

1. b

2. b

3. c

4. c

5. b

6. c

7. a

8. c

9. b

10. a