General aspects

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Introduction

Nowadays, the phenomenon of economic globalisation is booming, encouraged by the internationalisation of trade operations and the expansion of financial markets (increasing flow of capital, goods and services and rising mobility of labour, particularly qualified labour). Economic globalisation, meanwhile, is affected by the rapid emergence of information and communication technologies.

This leads, on one hand, to a greater presence of foreign companies in Spain, as well as growing activity by Spanish companies abroad. Meanwhile, the economic and social relationships of people go beyond national borders.

In turn, there are repercussions in the sphere of taxation. The effects of economic globalisation also spread quickly, making it necessary to know the tax criteria and consequences, as well as the formalities and actual tax obligations deriving from operations or transactions carried out in the international sphere.

As a result, situations where individuals or organisations obtain revenues in states other than the state where they are resident are increasingly frequent, meaning that each of these situations is affected by the tax legislation of the different states. As a result, situations of double taxation may arise. All these factors affect the tax position of such operations, which are characterised by their complexity and sophistication and must be covered by international tax law. Proper knowledge of this area enables the determination of which taxation system is applicable to such operations.

However, this must not undermine the taxation powers of states. The need for correct taxation of such operations in accordance with economic capacity is forcing tax administrations to modernise in this new environment, promoting the use of instruments for exchanging information with the tax administrations of other states to allow better tax control and the adoption of anti-evasion measures.

In these circumstances, like most states, Spain has reacted by increasing the signing of international conventions to prevent double taxation and by working on the detailed regulation of international taxation issues at domestic level. It should be stressed that the dynamism of this phenomenon compels states to carry out continuous tax reforms to adapt their regulations to the different tax planning instruments insofar as these can evade the proper application of national tax systems.

This issue is related to the concept of *fiscal sovereignty*, the application of tax regulations in space and the connecting factors determining the liability of an operation. Generally, the state of residence imposes its corresponding tax on all income obtained, regardless of the state it comes from, while the state where the income is generated taxes all income produced on its territory. But the two criteria are not exclusive, so they can lead to situations of double taxation of the same income in the same tax period, particularly in relation to income. This can be alleviated or eliminated with mechanisms such as conventions to prevent double taxation or measures adopted by the state of residence (as in the case of Spanish personal income tax or corporation tax). These taxes allow residents to deduct tax paid abroad in such a way that the deduction does not exceed the amount of tax that would have been payable in the recipient's state of residence if the income had come from that state.

Taxation will be different depending on whether an individual or organisation is considered to be resident in Spanish territory. Where this is the case, the tax that must be paid by individuals is personal income tax, while organisations are subject to the payment of corporation tax. In contrast, when dealing with the second case – non-residents in Spanish territory – they must pay income tax on non-residents, whether they are individuals or organisations. This is a direct tax imposed on the income obtained by people not resident in Spanish territory. This makes the determination of the residence of different people for tax purposes decisive.

Objectives

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

1. To identify the main issues related to international tax law.

2. To understand the concept of *international double taxation*, as well as the mechanisms established to alleviate or prevent its effects.

3. To understand what conventions to prevent international double taxation consist of.

4. To know about the different connecting factors and the consequences deriving from their use.

5. To recognise the notion and characteristics of the concept of *residence for tax purposes* in relation to international taxation.

1. International tax law

1.1. Concept

International tax law is responsible for regulating situations when the tax systems of two or more states could be applicable, particularly in the field of direct taxation.

This can happen for various reasons: because a taxpayer is resident in a state other than the one where he obtains his income; for being resident of a state different from the one where a property being taxed is located or because the person is considered to be resident in two or more states for tax purposes. In these cases, it is a matter of clarifying which of the affected states has the right to determine the tax burden.

Its **purpose** does not, therefore, consist of regulating taxes, as that power belongs to national legislators, but of regulating solutions in the event of conflicts between the tax systems of different states that may apply in these circumstances. However, the influence of the principles of international tax law on the configuration of national tax systems is undeniable.

Knowledge of tax systems

In practice it is important to know about the tax systems of the different states involved in these situations.

In this context, the main **purposes** of international tax law are, firstly, to avoid double taxation and, secondly, to prevent tax evasion. This is achieved through different mechanisms which will now be analysed.

Finally, it is appropriate to bear in mind that on this matter there are frequent disputes on interpretation and many controversial aspects. Such disagreements can stem from the diverse range of regulatory sources and case law criteria, particularly when these come from the tax authorities of different states.

1.2. Sources of regulations and soft law

The sources of international tax law are varied, and include regulations from international, EU and domestic agreements. Sources that can be identified include the following: international agreements, customary international law, EU law and domestic law.

1) International agreements

Among the most important of these sources (alongside domestic regulations) are international agreements which, in this area, are usually conventions to avoid double taxation (there may also be some tax clauses in general international agreements, although this is not common) and take the form of bilateral or multilateral agreements between states.

The **purpose** of these agreements is not to distribute taxation powers between two national jurisdictions, but rather to eliminate negative effects (such as international double taxation) generated by the legal/fiscal obligations of foreigners to the state where they have to pay tax, arising from the differences between the national tax systems. They therefore attempt to ensure the elimination of international double taxation, with the signatory states waiving a degree of fiscal sovereignty.

With this aim, they establish rules for apportioning tax powers between the states involved, depending on the degree of economic connection between them and the income or assets subject to taxation, as well as the nature of the income itself. Ultimately, they act as a limit on the contracting states' domestic tax regulations.

They also establish different classes of income, determining for each of them the distribution of tax powers between the contracting states. This is why it is essential to classify income according to the categories established in the double taxation conventions. It must be borne in mind that double taxation conventions do not create taxes or regulate their essential elements. This is the task of the domestic law of each of the contracting states. So, once the double taxation convention has determined which state is entitled to tax a particular piece of income, the tax is calculated in accordance with the domestic regulations of the competent state.

As is well known, after international treaties are ratified and published they come to form part of the domestic legal system of each state and, in all states, they generally prevail over domestic law. There are also **particular circumstances** concerning their repeal, amendment and interpretation, as an agreement cannot be unilaterally repealed or amended by one of the signatory states. Instead, the procedure established in the treaty itself must be followed and the clauses of the treaty are usually interpreted by mutual agreement between the states.

In this context, the Spanish Constitution points out that:

> "Duly concluded international treaties, once officially published in Spain, shall form part of the domestic system. Their provisions may only be repealed, amended or suspended in the manner established in the treaties themselves or in accordance with the general regulations of international law."
>
> Art. 96.1 CE.

Consequently, international treaties[1] take precedence over domestic regulations and come to form part of the legal system after they are published in the *Spanish Official State Gazette*.

(1)Art. 1.5 of the Civil Code.

In the tax sphere, this primacy of international agreements is recognised in the General Taxation Act (in article 7, concerning the sources of the tax system), when it points out that taxes will be governed:

> "By international treaties or agreements containing clauses relating to taxation and, in particular, by conventions to prevent double taxation under the terms established in article 96 of the Constitution."
>
> Art. 7.1.b LGT.

This primacy is also recognised in the laws regulating taxation, which establish (in their initial articles) that their content is understood without prejudice to the provisions of the international treaties and agreements forming part of the domestic legal system (for example, art. 5 Personal Income Tax Act or art. 3 Corporation Tax Act).

The practice of *treaty override*

In some states, such as the U.S., the United Kingdom and Australia, it is accepted that treaties can be repealed or ignored by subsequent laws, which amounts to violating these treaties, a practice which, in this sense, is criticised by the OECD.

It must be borne in mind that the agreements apply to the Spanish taxes in force at all times, even if they were not in force when the agreements were signed. This can cause problems when a previous agreement does not provide regulations for certain situations established in a subsequent domestic law.

A final particular feature consists of the treaties containing a specific individual procedure – what is known as the *amicable procedure* – making it possible to resolve conflicts relating to interpretation and application, and offering a solution to specific circumstances of double taxation occurring or not established in their development. They therefore constitute a mechanism for resolving disputes between two tax administrations when the action of one or both of them leads to double taxation or to taxation that does not comply with the double taxation convention signed between the two states.

Amicable procedure

A taxpayer affected by either of the contracting states sets the procedure in motion, without prejudice to his right to lodge ordinary jurisdictional appeals. This procedure does not take place before the courts of justice, but rather before a state body (in Spain, the Directorate General of Taxation).

In the case of the amicable procedures established in conventions to avoid double taxation, there is no obligation to provide a solution and, accordingly, no specific time period for providing such a solution. The convention does not provide an obligation to arrive at a result, only the goodwill to achieve one.

However, the introduction of a new section in article 25 of the OECD's Model Double Taxation Convention must be mentioned, which establishes a period for the tax administrations to reach an agreement. If none is reached, the possibility is established of going to a consultative committee to resolve outstanding issues between the two administrations. It is worth highlighting the approval within the OECD of a manual for the effective application of amicable proceedings.

In Spain, Royal Decree 1794/2008 of 3 November approves regulations for amicable proceedings concerning direct taxation (although it constitutes an alternative route for appeals that to date has been little used).

At EU level, there is also a regulation of this kind: the Code of Conduct for the application of Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

When the taxpayer is resident in a state with which Spain has signed a convention to prevent double taxation, the provisions established in the convention will be applied, as the international treaty is a hierarchically superior source of law to the ordinary law. Domestic regulations apply in all cases that do not contravene the provisions of the agreement, and when they are more favourable than the provisions of the Double Taxation Convention.

The interpretation of conventions

When a term is defined in the convention itself, this interpretation takes prevalence. However, if the convention does not include the definition of a term, domestic tax law must be taken into account (ahead of private legal regulations) unless the agreement makes other provisions.

Meanwhile, it must not be forgotten that a consensus interpretation must be sought between the contracting states, although a state does not automatically have to accept the interpretation made by the other state.

2) Customary international law

The sources of international tax law can also include customary international law, as this has generally been incorporated in written form in international treaties and in the precepts of the Vienna Convention on the Law of Treaties of 23 May 1969.

This is a spontaneous way of creating law: spontaneous because it arises thanks to a practice uniformly followed by states which, generally, with the passage of time, becomes consolidated as law.

By contrast, in EU law, customary law is not included as a source in the constituent treaties of the European Communities. However in its *International Fruit Company* judgment of 12 December 1972, related to the GATT, the European Court of Justice states that customary international law does form part of the EU law system of regulations.

3) EU Law

The integration of Spain into the European Union requires an analysis of EU Law as a system cutting across national systems. As pointed out by the European Court of Justice in case 26-62 *Van Gend & Loos*, of 5 February 1963 – recognising the direct effect of EU regulations – the EU constitutes:

> "a new legal system of international law in benefit of which the states have restricted their sovereign rights, although in limited fields".

Although taxation powers are the jurisdiction of the Member States, it is also true that there are EU regulations that affect domestic tax systems and that EU bodies can become involved in these matters if there is a distortion of the domestic market. Therefore, in this sense, EU law contains limitations on the taxation powers of all Member States.

Harmonisation

In addition, with this in mind there have been attempts to harmonise legislation, or bring it closer together, particularly in the area of indirect taxation (article 113 of the Treaty on the Functioning of the European Union). However, the timid advances in direct tax harmonisation in the European Union have been made up for by the extraordinary work of the Court of Justice of the European Union, which has largely harmonised national legislation through the principles contained in the European Union Treaty and the ban on discrimination in the internal market.

Concerning the **sources** of EU Law, a distinction is made between original law (the treaties constituting the European Union and their amendments) and derived law (orders made by EU institutions – regulations, decisions and directives).

Two **features** of the EU system are:

- the prevalence of EU law over domestic regulations and
- the direct effectiveness of some of these EU regulations insofar as they generate rights and obligations for all those affected, including individuals (who can invoke them not only before the EUCJ but also before national jurisdictional bodies).

Meanwhile, the influence of EU regulations on the treatment of residents and non-residents and specifically on determining the connecting factors to prevent discrimination or restrictions on EU freedoms, must be taken into account. Other issues related to international taxation are the EU regulations aimed at alleviating international double taxation between Member States, the regulations on customs duties, indirect taxes on international trade relations and the prohibition of public aid to companies.

The principles of prevalence and the direct effectiveness of double taxation conventions

The application of the principles of prevalence and direct effectiveness means the double taxation conventions signed by the different Member States between each other will not apply if they are contrary to or incompatible with EU law (unless they have been concluded before these states joined the EU, as provided for in article 351 of the Operational Treaty of the EU).

The relationship between international tax law and the EU

A matter arising from this issue concerns the relationship between international tax law and EU law, particularly the degree to which agreements to avoid double taxation have been influenced. The majority opinion upholds the existence of relationships between the two of them based on the principles of mutual influence and complementarity (in line with some CJEU rulings).

However, from the point of view of the appropriate coordination of the different tax systems, the lines of action of the OECD and the EU institutions increasingly coincide when it comes to establishing certain tax principles.

Even some EU institutions (Ecofin, the Commission and the ECJ) have referred to the need for EU tax regulations to adapt to the international taxation principles drawn up in the context of the OECD. This approach is known as the 'communitisation of treaties to avoid double taxation'.

4) Domestic law

As well as the above sources, there are domestic international tax law regulations governing issues such as the connecting factors of taxes, measures to prevent international double taxation, international tax evasion, the taxation of income obtained by non-residents and the taxation of income from foreign sources.

Domestic tax regulations apply when there is no Double Taxation Convention to act, as EU law does, as a limit to them. In addition, however, it must be borne in mind that the determination of the tax imposed on a transaction or on international income is carried out in accordance with the domestic regulations of the corresponding state. Also, the domestic regulation is also applied if it is more beneficial than the provisions of a Double Taxation Convention. Consequently, for these purposes, neither Double Taxation Conventions nor EU Law alone determine the applicable tax, rather it is usually the domestic regulations that do so.

The legal regulation governing the taxation of non-residents in Spain (regardless of whether they are individuals or organisations) is Royal Legislative Decree 5/2004, of 5 March, approving the Consolidated Text of the Income Tax on Non-Residents Act.

Meanwhile, the laws governing the taxation treatment applicable to income obtained abroad by residents in Spain are as follows: in the case of individuals, the Personal Income Tax Act 35/2006, of 28 November, and, concerning organisations, Royal Legislative Decree 4/2004, of 5 March, approving the Consolidated Text of the Corporation Tax Act.

Reference to regulations

The regulations concerning income tax on non-residents refer both to personal income tax and corporation tax regulations on certain issues, such as residence.

5) ***Soft law***

Together with the sources of law – called *hard law* – some provisions or instruments are available which, although they are not considered legal regulations and are not binding, are very important because they affect the creation or interpretation of hard law. This is *soft law*, which is usually handed down by international organisations to guide their actions and those of their members.

The areas in which these *soft law* provisions are adopted are the environment, human rights, banking standards, double taxation conventions and guidelines on transfer prices, transparency and information exchange.

Within the OECD, both the model convention to prevent double taxation and its comments, such as the black or grey lists of tax havens, are soft law. The UN's Model Convention is considered in the same way. Meanwhile, another kind of soft law adopted within the OECD and other international organisations – such as the WTO – are codes of conduct, guidelines, communications, etc., which have the aim of establishing or codifying uniform parameters at international level.

In the sphere of the European Union[2], it is established that EU institutions can hand down recommendations and decisions that are not binding. The Commission can also draw up directives and codes of conduct.

(2) Art. 288 TFEU.

The legal value of European Union soft law decisions

In its Judgment of 13 December 1989, the European Court of Justice (case *Grimaldi* 322/88), points out that "national courts are bound to take recommendations into consideration in order to decide disputes submitted to them, in particular where they cast light on the interpretation of national measures adopted in order to implement them or where they are designed to supplement binding EU provisions".

1.3. Principles of international taxation

There is a series of international taxation principles, which assume a kind of 'minimum fiscal consensus' for the majority of States and are usually present in model agreements, in addition to the prohibition of international double taxation (which will be analysed later).

These basically concern the principles of non-discrimination, reciprocity and international courtesy, good faith in international tax relations and administrative technical assistance.

1) Principle of non-discrimination

Modern tax systems are characterised by treating residents and non-residents differently. This different treatment can lead to some tax advantages for certain taxpayers and situations of tax evasion.

One of the main limits of international tax law is the principle of non-discrimination. Thus, states sign an agreement pledging to give analogous tax treatment to:

- residents of these states for tax purposes, regardless of their nationality (this is deduced from article 24 of the OECD's Model Agreement);
- one state's permanent establishments located in the other state, by comparison with the tax legislation applicable to any resident company carrying out the same activity, and
- the companies carrying out their activity in a state, regardless of whether their shareholders are resident in another state and by comparison with the tax legislation applicable to companies in the first state with resident shareholders.

The principle of non-discrimination and European Union law

This principle also exists in EU Law. According to it, equal tax treatment must be given to the people and companies resident in EU Member States. Tax discrimination against non-residents is generally a concealed form of discrimination due to nationality, prohibited by EU Law. In this respect, the interpretation of this principle by the CJEU must be borne in mind. It has issued many judgments on this issue in which it relates non-discrimination by nationality with the criteria for the prohibition of discriminatory tax measures restricting the freedoms of establishment and circulation of capital and people, and the free provision of services (for example the Bachmann judgment of 28 January 1992 C-204/90 and the Wielockx judgment of 11 August 1995, C-80/94, both from the CJEU, which, concerning insurance and pensions contracts respectively, prohibit discrimination within the EU).

2) Principle of reciprocity and international courtesy

Through the principle of international courtesy or reciprocity, an attempt is made to equalise tax concessions made mutually between states.

This principle can be established in two ways: through international agreements signed between states or through domestic tax regulations approved by each state. In double taxation agreements, the tax system for people who exercise public functions in other states is governed by the principle of international courtesy.

The application of this principle assumes that states mutually grant favourable treatment to one another and to their diplomatic representatives. This treatment is also extended to civil servants working abroad in official jobs or posts that are not diplomatic or consular.

The OECD model agreement

In this context, article 19.1 of the OECD model agreement, entitled 'Government service', governs only the distribution of powers over the taxation of civil servants and does not go into the matter of the tax privileges enjoyed by diplomatic and consular agents. The general rule is, therefore, that the right to tax remuneration of civil servants corresponds to the state of residence of the body that pays them, although they can be subject to taxation in the other country if they meet one of the two conditions included in article 19.1.b). This latter requirement is nuanced in some of the agreements signed by Spain.

Spanish internal regulations also sometimes refer to this principle of reciprocity. An example is article 9.2 of the Personal Income Tax Act, according to which "foreign nationals who have their habitual residence in Spain shall not be considered to be taxpayers when this circumstance is a consequence of one of the circumstances established in section 1 of article 10 of this Act and there is no application of specific regulations deriving from international treaties to which Spain is a party".

3) Principle of good faith in international tax relations

The agreements are international legal regulations, as we have seen and, as such, they must be interpreted in accordance with the provisions of the Vienna Convention on the Law of Treaties, of 23 May 1969.

In particular, article 31 establishes that an international agreement shall be interpreted in accordance with good faith, in accordance with the normal meaning of terms, taking into account the context, objective and purpose of the treaty. This principle is therefore related to the interpretation of agreements.

4) Principle of administrative technical assistance

Nowadays, considering the globalisation and complexity of trading operations, states need to adopt formulas for cooperation. Because of this, clauses are usually introduced into conventions to promote the exchange of information between the signatory states in order to guarantee their proper application and prevent fraud and tax evasion.

Procedures are also established at EU level procedures for exchanging information and cooperation in collection.

1.4. Fiscal sovereignty and connecting factors

1) Fiscal sovereignty and the effectiveness of law in space

Fiscal sovereignty is one of the manifestations of *state sovereignty*. Thus, the power to create and establish taxes is a key element in the concept of the *sovereignty of a state*, together with the right to mint money and the use of military force.

The European Union and fiscal sovereignty

In the area of the EU, EU institutions have attracted these last two powers to themselves through monetary union and common foreign and security policy. By contrast, on taxation matters, they only attempt to coordinate, or rather harmonise, tax policies.

The concept of *fiscal sovereignty* is related to the application of tax regulations in space. In other words, a state exercises its fiscal sovereignty within its territorial frontiers. This is what is known as the **territoriality of taxation**. In the international sphere, the tax sovereignty of each state is, as might be expected, limited by the existence of other fiscal sovereignties.

Circumstances of double taxation or non-taxation

Sometimes, it may be that a certain transaction or activity is subject to tax measures emanating from the two states (positive conflict), leading to double taxation.

It may also be that neither state has adopted a tax measure (negative conflict), which means no tax is paid on the transaction and there may be tax evasion, sometimes deliberately caused by states themselves in order to attract capital or people to their territory, making them tax havens.

Fiscal sovereignty is also related to the effectiveness of the law in space and its extent.

Effectiveness and extent of law

The effectiveness of law in space is intended to mark the spatial scope within which tax law produces its effects.

The extent of the law is intended to establish the criteria determining whether a transaction is subject to tax regulations. It involves connecting factors.

Generally the two issues coincide, but they sometimes differ so that:

- The extent of the law is more limited than the territorial scope within which that law is compulsory. For example, certain foreigners (diplomats, consular civil servants and international bodies) are not subject to personal income tax, even though they reside in Spain.

- Or, on the contrary, the territorial scope is more limited than the extent of the law. For example, in the case of VAT, operations which have been carried out abroad, such as the intra-EU purchase of goods are subject to taxation at destination and not at origin and they are understood to have been carried out on the peninsula or the Balearic Islands.

2) Connecting factors

The **connecting factors** – or criteria for subjection to each tax – serve to delimit whether a transaction, activity, operation or revenue is subject to the Spanish tax system rather than those of other states. The purpose of the connection criteria is to determine whether, for example, the income obtained in Spain by a German resident is subject to any Spanish tax.

Such connecting factors **are determined** in two ways. Firstly, they can be fixed unilaterally by a state. Each state will apply the most favourable criterion from the point of view of collection, which is usually residence. Secondly, connecting factors can be agreed by international treaty, to avoid possible conflicts deriving from the existence of two or more domestic systems affecting the same income.

Domestic connecting factors

There are also domestic connecting factors, particularly concerning the taxes transferred by the Spanish government to its autonomous communities.

Connecting factors are particularly important for states because they determine which of them can tax all or part of the income (and which, as a result, will collect more or less). However, it is also important for taxpayers, as whether they pay more or less tax will depend on these connecting factors. The choice of one connection criterion or another is a fact that also affects taxation powers between states, making it a matter that is not wholly neutral; it has important consequences for taxation, and for collection in particular. In addition, the possibility that people with higher incomes can move to tax havens also affects the decisions other states might make.

The different model agreements include different subjection criteria. Exporting countries are generally interested in income being taxed in the country of residence (the country of the vendor or receiver of the income) so they can receive a share of income not originating in their territory. This also alleviates the tax burden on investments made by their residents abroad. By contrast, importing countries are interested in the criteria specifying the source, so that a part is taxed in the country of the source of the income (the country of the purchaser or payer).

Generally, the **criteria that can be applied** are the nationality or the territoriality and residence, each of which has a well-defined scope:

a) Nationality. According to the criterion of nationality, tax regulations apply to all citizens who posses the nationality of a state, regardless of where they live or obtain their income, where their assets are or where they carry out the corresponding taxable transaction.

Example

A German national living in Germany obtains income in Spain.

If both Spain and Germany apply the nationality criterion, the taxable person will not pay tax in Spain (source country). Instead they will be subject to taxation in Germany for all their income. And, although they may live in Spain, they will also pay tax in Germany for their worldwide income, as they are a German national.

This criterion has gradually been replaced in Spain by that of territoriality and residence, as it has in most neighbouring countries (except for the U.S.), as it is one of the criteria that makes tax evasion easiest. However, nationality preserves its importance as a means of resolving dual residence conflicts and for the application of the principle of non-discrimination.

Double taxation and dual nationality

In theory, there could be circumstances of international double taxation due to dual nationality, although in practice it is difficult for this to happen because few states use this criterion.

b) Territoriality. In accordance with the territoriality criterion, tax laws are applied only to those living on Spanish territory or those who, although they do not live on Spanish territory, have an economic relationship or link with it: obtaining income, owning goods located on Spanish territory or maintaining economic relations with that territory. It is therefore the territory or place where the event (operation, transaction, income, etc.) occurs that decides the applicable law. This is a real and objectively linked criterion.

Example

A German national living in Germany obtains income in Spain.

According to this territoriality criterion, the taxpayer pays tax in Spain for the income obtained on Spanish territory.

Disadvantage

If territoriality is the only connection point used, there can be capital export, as it incentivises residents to invest abroad.

c) Habitual or actual residence. One manifestation of the principle of territoriality is that of residence, although in Spain, as we will see, legislators become confused in that they contrast the two principles as if they were opposites, when in fact, the latter is a subcategory of the former. In other words, the principle of residence is one of the manifestations of the principle of territoriality involving a territorial link of the taxpayer in space. It is a personal criterion and a subjective link. The specific criteria used to determine the residence of a taxpayer are established by the regulations involved in each tax.

Example

A Mexican company sells computers to another company resident in Spain.

According to the residence criterion, the taxpayer would pay tax in Mexico for its worldwide income. By contrast, according to the source criterion, the vendor company would pay tax in Spain for the income obtained there.

With the residence criterion, it is the economic link with the state (obtaining income on its territory or maintaining economic relations), rather than the political one, characteristic of nationality, that becomes important. The use of the habitual residence criterion therefore leads to a kind of fiscal citizenship.

However, the habitual residence criterion raises problems deriving from the variety of rules used by the tax laws of different states when it comes to defining residence, and this can generate situations of dual residence. Such conflicts are resolved in double taxation agreements by the establishment of an order of priority for residence determination criteria.

3) Connecting factors in the Spanish tax system

Article 11 of the General Taxation Act 58/2003 of 17 December establishes the following: "Taxes shall be applied in accordance with the criteria of residence or territoriality established by the law in each case. Failing this, personal taxes shall be enforceable in accordance with the residence criterion and other taxes in accordance with the most appropriate territoriality criterion with respect to the nature of the taxable event." So, the effective residence of a person on Spanish territory, in accordance with the regulations established in the corresponding tax, is the element determining subjection to the Spanish tax. In this context, most countries use the effective residence criterion for personal taxes.

As a result, tax legislators establish effective residence (tax is paid for all the taxpayer's worldwide income) and territoriality (source of the income) as criteria for subjection to Spanish tax laws, excluding nationality from the connecting factors (nationality is taken into account only in exceptional circumstances, as in the case of article 8.2 of the Personal Income Tax Act, which is simply an anti-tax haven measure).

It is important to stress that the criteria of article 11 of the General Taxation Act are not an absolute rule; they are subsidiary to those established in the laws regulating the different taxes. In personal income tax, the actual residence criterion is used; by contrast income tax on non-residents uses the territoriality criterion.

In fact, the criterion governing the application of tax regulations in space will be, in the first place, the provision of the regulations governing the corresponding tax. Subsidiarily to this, when there is no specific instruction in this respect, the residence or, as appropriate, territoriality criterion will be applied, depending on the nature of the respective tax. This determines that article 11 of the General Taxation Act is rarely applied in practice, as the regulations established in most taxes set the applicable criterion.

2. International double taxation

2.1. Concept, causes and effects

When the international factor is present, there can be double taxation phenomena, especially concerning matters of income and wealth. This happens because the connecting factors, which each state establishes under its sovereignty and which determine the subjection to taxation of a source of income (residence, place where the income is produced, place where the asset is located, etc.), attributing it to two or more states.

This situation occurs when income is received or assets are held in territory other than that where the taxpayer resides, and the two states (the **source** state and the state of **residence**) try to tax the same income or property obtained by the same taxpayer in a certain period under cover of their fiscal sovereignty (or by applying two different subjection criteria or the same one interpreted in different ways, or because both states attribute residence to the taxpayer).

- On one hand, the source state, considering the principle of territoriality, subjects income obtained in its territory to taxation regardless of the state it comes from, through the corresponding tax.
- And, on the other hand, the state of residence, applying the principle of actual residence, subjects the taxpayer to tax for his worldwide income.

Domestic double taxation

It must not be forgotten that situations of double taxation can also occur in the domestic sphere.

If all states applied the principle of residence (if people paid tax only in the state where they reside) or territoriality (if people were only subject to tax in the area where they obtain income) the possibilities of there being double taxation would be reduced.

Example

Mr. Martínez, who is Spanish, normally lives in Barcelona. In May 2008 he repairs some computers in Cameroon, an operation for which he receives 3,000 euros.

A situation of double taxation will occur if the state of residence (Spain) imposes personal income tax on all income obtained by Mr Martínez, regardless of the state from which it comes from and, at the same time, the state in which the income has been generated (Cameroon) taxes all income produced in its territory.

For these purposes, a distinction is usually made between two types of double taxation: economic and juridical. The first case, **economic double taxation**, occurs when two different people are taxed for the same income or asset via

two different taxes. This kind of double taxation does not generate the need to reach a solution in the international sphere (unlike double juridical taxation), as it is a phenomenon occurring frequently in the domestic systems of almost all countries. It usually occurs in the sphere of taxation of dividends and is called *inter-company double taxation*.

Example

Mrs. Rodríguez, resident in State A, receives dividends from a company resident in State B.

In this case, there is a situation of economic double taxation because the company will pay corporation tax in its state of residence and Ms. Rodríguez will pay personal income tax in her state of residence.

Juridical double taxation requires not only that two or more states tax the same taxable event or manifestation of economic capacity in the same tax period and that the tax paid is the same one, of similar nature. The taxpayer must also be juridically the same. In other words, in these cases, the same taxpayer pays the tax twice for the same taxable event. Ultimately, the same income and the same taxpayer are taxed for the same tax period.

A principle of international tax law is that the same taxable transaction cannot be taxed twice simply because it is linked to two countries. There is therefore a consensus when it comes to considering the elimination of international juridical double taxation to be a priority objective, for reasons of justice and economic order affecting not only taxpayers but also states themselves, as international double taxation breaches the principle of tax neutrality.

The **effects** of international double taxation affect not only for taxpayers involved in taxed transactions, but also economic relations between the states and the proper operation of the internal market.

Some of the negative consequences are as follows: international double taxation prevents the fair international distribution of the product of taxation. It can negatively affect production and trade, as it means the reduction of the profitability of investments and operations carried out by residents, the delocation of investments and assets and the diversion of income to places where tax costs are lower or to tax havens. Finally, it leads to unequal treatment for people who have relations with or who are linked to more than one state.

Because of this, the cause of international double taxation can be found in:

1) The use of different criteria for subjection to taxation by states (which is the most frequent circumstance).

Example

When dealing with the same income of a taxpayer, State A uses the residence criterion (which taxes all income obtained by the resident regardless of the place where it has been generated), and State B uses the source criterion (which subjects the income produced in its territory to taxation), either exclusively or in combination.

If there is no treaty to avoid double taxation or any kind of unilateral measure approved by either of these states, a situation of international double taxation occurs.

2) The use of the same criterion for subjection to taxation, such as the residence criterion, but configured differently. This happens when a taxpayer is considered a resident in two or more states that use the residence criterion, and different criteria are used to define residence (or these criteria are interpreted differently).

Example

Mr. Méndez owns a flat in State A; his business activities are based in State B and he obtains his income there; he actually lives in State C.

In this case, the taxpayer could be considered a resident in three states, and he would have to pay the same tax in each of them.

If this taxpayer was also a national of another state with which he had nationality as a connecting factor, such as the United States (even if he had not been resident in that country for years, nor obtained income there, nor possessed any assets there), the taxpayer would have to pay for his worldwide income in four states.

Very serious consequences

In these cases, the consequences are more serious than in the case of the use of two different connection criteria, as the taxpayer must pay tax for all his worldwide income in two or more states, while in the case of the use of two different criteria, the double taxation may be only partial (for a particular income).

These circumstances also occur when two or more states understand that a certain taxable event (obtaining income) has occurred on its territory. In this case, these states use the same connection principle – territoriality – to determine the situation of the source, but based on different criteria.

Example

Ms. Fernández, resident in State A, concludes an international purchase/sale contact with Ms. González in State B, but it is implemented in State C.

Under the principle of territoriality, the taxpayer could be obliged to pay tax both in State B and in State C for the income generated by the purchase/sale.

3) Finally, it must be borne in mind that situations of international double taxation occur not only because of the existence of different connecting factors included in the regulations but also because of the different interpretations made of these regulations by the administration and courts.

2.2. Types of measures to eliminate or alleviate double taxation

These double taxation conflicts can be eliminated, or at least alleviated, through different measures and methods, particularly in the field of different kinds of income tax.

There are two kinds of measures that the states can adopt to avoid double taxation:

1) Unilateral. These are measures generally adopted by the state of residence (as in the case of Spanish personal income tax, corporation tax or inheritance and gifts tax), coming into play in the absence of a convention. These taxes allow residents to deduct the amount of tax paid abroad, with certain requirements (so that such a deduction may not exceed the amount that would have had to have been paid in the recipient's state of residence if the income had come from that state).

Deductions to prevent double taxation in personal income tax and corporation tax

Thus, in accordance with the provisions of the Corporation Tax Act[3], the lower of the following two amounts can be deducted: the actual amount paid abroad due to a tax identical or analogous to corporation tax, or the full amount that would have to be paid in Spain for such income, including the foreign tax, if it had been generated on Spanish territory. Tax not deducted due to a shortfall in gross tax payable may be deducted in subsequent tax periods. However, the period the Administration has to check pending deductions is limited to ten years.

Meanwhile, the Personal Income Tax Act[4] includes the deduction of the lower of the following sums: the actual amount paid abroad due to a tax identical or analogous to personal income tax or income tax on non-residents or the result of applying the actual average tax rate to the part of the net taxable base taxed abroad (the average tax rate is the result of multiplying by 100 the quotient obtained by dividing the total tax liability by the taxable base; a difference is established between the tax rate corresponding to general income and the rate for savings). This exemption is applied to permanent establishments rather than the one established in article 22 of the Corporation Tax Act.

(3)Art. 31 of the Corporation Tax Act.

(4)Art. 80 LIRPF.

2) By convention (multilateral or bilateral). These are the measures included in international treaties or, in particular, in conventions to prevent double taxation.

When the convention attributes the imposition of the tax exclusively to the state of residence (which is the normal practice) or to the source, double taxation is avoided. However, if the agreement allows both states to tax the income (regardless of whether a maximum limit is established), there is double taxation, which is usually alleviated in the state of residence using one of the methods analysed below.

Tax harmonisation

Tax harmonisation is a third route that is also worth mention. This is the convergence of the tax structures of countries belonging to a supranational body, such as the European Union.

Although all the countries will adopt the same connection criteria, in order to eliminate international double taxation, the same interpretation of these connecting factors is required, as well as harmonisation of tax structures.

2.3. Methods for eliminating or alleviating double taxation

The different methods established in the different agreements can be classed in two main groups (exemption and credit method or allocation) together with some others (such as credit).

In all cases, it must be borne in mind that each state decides the methods it will apply domestically. Meanwhile, there are as many possibilities as variants that the states decide to introduce when it comes to signing conventions, so the specific rules and the ways the exemption must be applied remain up to them, as well as the criteria for calculating the deduction.

Application by the country of residence

These methods are applied by the state of residence and involve a reduction in the tax paid there considering the amount already applied in the source state. The difference between these methods lies in the way of determining and applying this reduction, which can vary depending on the case.

All the methods have advantages and disadvantages and, to find out which is the best, it is necessary to analyse the structures and principles of the tax systems (how the tax base and rate are determined, management procedures, etc.) case by case; as well as the purposes sought with the signing of the agreement, although it can be stated that, in general, the credit method better respects the principles of equality, fairness and economic capacity.

1) Exemption method

In this method, the state of residence of the taxable person, where he pays tax for all the income obtained, leaves income generated abroad exempt, as tax has been paid on it in the state or territory where the income has been obtained. This means the state of residence waives fiscal sovereignty in favour of the benefits of the investment made abroad. In this sense, the taxable bases (those from the state of residence) are separated from the exempt ones (from abroad). Taxable bases and income (exempt income and income subject to tax) are therefore placed in different packages.

The application of this method in the state of residence can cause capital export, as taxation is lower, as well as discrimination against residents who do not invest abroad.

Two forms are distinguished: full exemption and exemption with progression.

Irrelevance of the tax in the source state

To apply this method, the tax paid in the source state is irrelevant, so it is not necessary to know it, as this tax is not taken into account for calculating the tax that must be paid in the state of residence.

a) Full exemption. On demanding tax from its resident, the state of residence fully waives taxation of income from abroad (it is as if the income did not exist); this income is exclusively taxed by the source state. In addition, with this method, there is a more than proportional reduction of the income in the state of residence, as exempt income is not taken into account for fixing the progressive tax rate applicable to the other income. In addition, this method places a foreign investor and residents of the source state in a situation of equality from a fiscal point of view (so the tax benefits of the source state are not reduced or abolished by the state of residence).

The loss of income in the state of residence is usually greater than the tax received in the source state, even when the tax rate is higher in the source state. For this reason, this method is not normally applied either domestically or in conventions.

Example

A taxpayer obtains income of 10 in State A (the source state) and income of 100 in State B (the state of residence). The tax rates in the states are 20% and 30% respectively.

With the application of this method, the taxpayer would pay 2 in State A (the taxable base would be 10, to which a rate of 20% would be applied) and 30 in State B (the taxable base would be 100 and the tax rate 30%).

Had State B taxed the income obtained in State A, the tax payable would have been 33 (110 x 30%) so the sum State B gives up for the income obtained abroad (33 - 30 = 3) is greater than that collected for this income in State A (2).

b) Exemption with progression. The state of residence also waives taxing the income obtained abroad, so it is not taxed in the taxable person's state of residence, as in the previous case. However, the income obtained abroad is taken into account when it comes to calculating the taxable amount (it is added to the other income obtained by the taxable person) only in order to find out the tax rate, which will therefore be applied only to the income obtained in the state of residence.

The amount that must be paid in the state of residence applying this method is higher than the result of the full exemption method, as the tax rate is calculated on the taxpayer's worldwide income but applied only to the income obtained in the state of residence.

Example

A taxpayer obtains income of 10 in State A (the source state) and income of 100 in State B (the state of residence). The tax rates in the states are 20% and 30% respectively.

The taxpayer would pay 2 in State A (the taxable base would be 10, to which a rate of 20% would be applied. In State B, the taxable base would be 100, but the tax rate would now not be 30% but rather 35%, for example, as the progressive tax would be taken into consideration to determine a taxable amount of 110 (100 + 10). As a result, the taxpayer would pay 35 in State B.

Progressive taxes

This method makes sense only for taxes with a progressive tax rate because, as the base goes up, the tax to be paid also progressively increases, and the principle of progressiveness of the tax system is respected.

2) Credit method

The state of residence taxes all income obtained by the taxable person but allows the amounts paid abroad for income of foreign origin to be deducted from the tax liability. So, this method includes all income, including that obtained in the source state, in the taxable base. There is also a degree of division of payments (one corresponds to the source state and the other corresponds to the state of residence).

Once again, two broad forms of this method can be distinguished: full credit method and ordinary credit method.

Time of deduction

Generally, this deduction is applied once the other appropriate deductions have been carried out, in accordance with domestic regulations.

a) Full credit method. The state of residence allows the deduction from the tax payable of the entire amount paid in the source state, without any kind of limit. As a result, the amount of the deduction coincides with the tax paid abroad.

Example

A taxpayer obtains income of 10 in State A (the source state) and income of 100 in State B (the state of residence). The tax rates in the states are 20% and 30% respectively.

The taxpayer would pay 2 in State A (the taxable amount would be 10, to which a rate of 20% would be applied. In State B, the taxable amount would be 110 and the tax rate would be 35%, so the full tax payable would be 38.5 (110 x 35%). From this full tax payable, the amount payed in State A would have to be deducted, leaving a gross tax payable of 36.5 (38.5 – 2).

b) Ordinary credit method. The deduction (or tax credit) for the tax paid abroad must never exceed the amount of the tax that would have been due in the country of residence had the income from abroad been obtained in the country of residence. The deduction must therefore be applied with certain quantitative limits.

Example

A taxpayer obtains income of 50 in State A (the source state) and income of 60 in State B (the state of residence). The tax rates in the states are 35% and 30% respectively.

The taxpayer would pay 17.5 in State A (the taxable base would be 50, to which a rate of 35% would be applied). In State B, the taxable base would be 110 and the tax rate would be 30%, so the total tax liability would be 33 (110 x 30%). The amount paid in State A may be deducted from the total tax liability but may not exceed the amount that would be payable in State B if the income from State A had been obtained there. Therefore, the total tax payable corresponding to State B is multiplied by the income obtained in State A and the result is divided by the worldwide income obtained by the taxpayer. So, the deduction applicable for the amount paid in State A will be just 15 (and not 17.5). As a result, the net tax payable of the taxpayer in State B would be 18 (33 – 15).

Quantitative limit of deduction

If the tax paid in the source country does not exceed that which would be payable in the country of residence for the income obtained abroad, the two methods (full credit and ordinary credit method) lead to the same result, as the difference between the two lies only in the quantitative limit of the deduction.

This is precisely the system followed in Spain. Thus, the Personal Income Tax Act governs a deduction for international double taxation that consists in applying the lesser of the following two amounts: the actual amount of tax paid abroad, provided it is identical or similar to personal income tax or non-residents' income tax or the result of applying the actual average tax rate to the part of the net taxable base taxed abroad[5].

(5) Art. 80 LIRPF.

Other forms of apportionment

As the credit method cancels out the source state's tax benefits for attracting foreign investment (because the lower tax in the source state means a lower deduction in the state of residence), there are means of allowing a deduction in the state of residence greater than the tax actually paid in the source state. It is therefore a matter of making a fictitious tax deduction using a *tax sparing credit* or a *credit for notional tax*. Such means do not appear either in the OECD's or the UN's Model Double Taxation Conventions.

3) Other methods

As well as the above, there are other possible methods of trying to alleviate (rather than eliminate) international double taxation, although they are not included in any agreement and are applied unilaterally by just a few states. They are the following:

- **Deduction method**. The tax paid abroad is considered as a cost deductible from the resident's worldwide income. It therefore acts as a cost necessary for obtaining income and is taken into account in calculating the taxable base.

- **Special tax rate or double rate method**. Income generated abroad is taxed in the state of residence at a special tax rate.

3. Conventions to prevent double taxation

3.1. Application of conventions and purposes

Conventions to prevent double taxation establish **rules for distributing taxation powers** between the states involved (the source state, or the state where the income originates, and the state of residence of the recipient of the income) depending on the degree of economic connection between them and the income or property subject to taxation, and taking account the nature of the income. However, once this allocation has been established, the specific determination of the tax to be paid is carried out in accordance with domestic regulations.

As a result of the application of these provisions of the conventions, in some cases taxation is lower than it would have been had Spanish tax regulations been applied to Income Tax on Non-residents and, in others, the income cannot be subject to taxation in Spain if certain circumstances arise.

The bilateral nature of conventions

These conventions, which are generally bilateral, bind only the contracting states, not other states, so the problem is not totally resolved.

When the taxpayer is resident in a country with which Spain has signed a convention to prevent double taxation, the provisions established in the agreement will be applied, because the international treaty is a source of law hierarchically superior to ordinary law. Spanish tax law on income tax on non-residents will apply concerning anything that does not contravene the provisions of the convention, as it will if it is more favourable than the provisions of the agreement. And when the taxpayer is resident in a country with which Spain has not signed a convention, the provisions of Spanish tax regulations will apply.

As a result, the main **purpose** of this type of convention signed between states that have thriving trade relations is to prevent international double taxation and, to a lesser extent, to combat tax evasion. However, other purposes are also involved, such as facilitating and attracting foreign investment, achieving neutral tax treatment so as not to affect the delocation of income and assets, seeking the effect of harmonising the different tax systems of the signatory states, facilitating the exchange of tax information and applying the principle of non-discrimination between residents and non-residents.

Measures brought about in conventions are the means for preventing international double taxation that have been developed most, and they have achieved very effective results. These measures also constitute a fundamental

tool for developing international trade, and they usually incorporate a clause for the exchange of information, which is an effective tool for the fight against tax evasion.

Advantages of signing a double taxation convention

The main advantages of signing a convention are as follows:

- Developed countries (exporters) see that their investments are not taxed excessively and their exports are encouraged.
- Developing countries (importers) can increase their economic development.
- Sometimes agreements include clauses called *tax sparing clauses* to promote investment in developing countries, allowing a deduction in the amount payable in the country of residence or to encourage cooperation between states in fighting fraud and tax evasion. This has been done in Spain's agreements with the Federal Republic of Germany, Brazil, Canada, Czechoslovakia, Italy and Great Britain.

Agreements for the prevention of double taxation and for administrative assistance depend on three well differentiated **areas**: income and wealth tax; inheritance tax and, finally, taxation of income from international maritime and air navigation. However, the most important of them – both quantitatively and qualitatively – are conventions concerning income and property tax, because of the extent of their provisions.

Basic issues concerning Double Taxation Conventions

The most important thing about a double taxation convention is the taxation of royalties, dividends and interest, and also the information exchange clause, as this makes the application of the agreement operational.

Meanwhile, limited tax information exchange agreements are also signed between territories classed as tax havens and OECD states.

Model Double Taxation Conventions are not strictly speaking agreements, so they are not regulations. They are *soft law* provisions serving as a pattern for states for drawing up agreements. Regulations are the specific conventions signed by two or more states.

The states can introduce changes to the text of the model. This is one of the reasons why there are differences between some agreements and others. However, the same structure and general issues are usually maintained in all agreements.

3.2. Different models of double taxation conventions

Different bodies and international conferences have promoted studies on the need for states to have a sufficient network of conventions and for these to be drawn up in accordance with homogeneous or at least uniform criteria. In fact, for some time many of them have had a **model Double Taxation Convention** that is **updated** to adapt it to the needs deriving from a globalised economy.

As early as 1920, the League of Nations began work along these lines, establishing an Economic and Financial Commission. Nowadays, the elimination of international double taxation is a fundamental issue developed within organisations like the UN, the OECD, the EU, the OAS, the Group of Experts of the ALALC (Latin American Free Trade Association, set up in 1960 and replaced after 1980 by the ALADI (the Latin American Integration Association) and the Andean Pact (the Andean community began in 1969), and in non-governmental institutions like the International Fiscal Association, the Institut de Droit International and the International Chamber of Commerce.

However, it must be pointed out that there are variations in the different conventions signed by states based on the same model convention. These variations occur for different reasons, such as the circumstances of the state with which the agreement is made, the economic situation when it is negotiated, the existence of different versions of the model Double Taxation convention and the long periods between the signing of some agreements and others.

States with their own Model Double Taxation Convention

There are even countries who have their own model conventions which they use for negotiation purposes, such as the U.S. (*United States model income tax convention*) and the Netherlands.

Among all of them, the agreements based on the model convention of the Organisation for Economic Cooperation and Development (OECD) are the most important, an organisation that includes the Committee on Fiscal Affairs, in charge of drawing up principles. Spain has signed many conventions of this kind, particularly in relation to personal income tax and wealth tax, which are available on the Spanish tax agency's website.

The OECD's Model Convention usually places greater importance on the criterion of residence than the UN model (drawn up in 1980 and reviewed in 2001), in which the source criterion takes precedence.

Since the seventies, Spain has begun to develop a network of double taxation conventions concerning income and property tax which nowadays covers almost all states with which it maintains a certain level of economic relations. The convention signed by Spain generally follows the OECD model agreement, with nuances in the case of the one signed with the United States.

Countries with which Spain has conventions

<table>
<tr><th>European Union</th><th colspan="2">Other countries</th></tr>
<tr><td rowspan="5">Austria
Belgium
Bulgaria
Cyprus
Czech Republic
Denmark
Estonia
Finland
France
Germany
Greece
Hungary
Ireland
Italy
Latvia
Lithuania
Luxembourg
Malta
Netherlands
Poland
Portugal
Romania
Slovakia
Slovenia
Sweden
United Kingdom</td><td>Europe</td><td>Albania
Armenia
Bosnia and Herzegovina
Croatia
Georgia
Iceland
Kazakhstan
Macedonia
Moldova
Norway
Russian Federation
Serbia
States of the former USSR (except Russia)
Switzerland
Turkey</td></tr>
<tr><td>Africa</td><td>Algeria
Egypt
Morocco
Senegal
South Africa
Tunisia</td></tr>
<tr><td>America</td><td>Argentina
Barbados
Bolivia
Brazil
Canada
Chile
Colombia
Costa Rica
Cuba
Dominican Republic
Ecuador
El Salvador
Jamaica
Mexico
Panama
Trinidad and Tobago
Uruguay
U.S.
Venezuela</td></tr>
<tr><td>Asia</td><td>China
India
Indonesia
Iran
Israel
Japan
Kuwait
Malaysia
Pakistan
Philippines
Saudi Arabia
Singapore
South Korea
Taiwan
United Arab Emirates
Vietnam</td></tr>
<tr><td>Oceania</td><td>Australia
New Zealand</td></tr>
</table>

Recommended reading

T. Sánchez Fernández (2004). “Estudio comparativo de los convenios suscritos por España respecto al convenio modelo de la OCDE”. *Documents of the Institute of Fiscal Studies* (num. 1).

Spain also has conventions signed with France, Greece and Sweden to prevent double taxation concerning inheritance tax.

Furthermore, it has conventions signed with Chile, South Africa and Venezuela to prevent double taxation on income coming from maritime and air navigation.

A convention has also been signed with Cyprus to correct the profits of associated companies.

Finally, information exchange conventions have been signed with Andorra, the Netherlands Antilles, Aruba, the Bahamas and San Marino.

3.3. The OECD Model Double Taxation Convention

1) The versions of the Model Double Taxation Convention

The first model convention to prevent double taxation in the area of income and property and its comments date from 1977 (although the draft model agreement appeared in 1963). Other conventions are from 1994, 1995, 1997, 2000, 2003, 2005 and 2008. The **latest OECD Model Convention** is from **2010.**

In practice, this model has allowed a degree of harmonisation of all domestic legislation in the countries of the OECD. There is also a model convention for tax on inheritance and gifts, published in 1966 and reviewed in 1982 and another for administrative assistance concerning tax collection, from 1981.

The Model Convention, as has already been made clear, is subject to periodic reviews, which are implemented as a way of ensuring it is always up to date with international tax affairs.

The periodic reviews of the Model Double Taxation Convention

In these reviews, the following are taken into account:

- the experience acquired by OECD member countries in negotiating their agreements to avoid double taxation,
- changes in the tax systems of member countries,
- the increase in international tax relations and
- the development of new sectors and formulas for business activity (such as e-commerce, for example).

2) Commentary on the Model Double Taxation Convention

Together with the Model Double Taxation Convention, mention must be made of the Commentary on its development drawn up by experts from different OECD member countries, which constitutes an effective instrument for resolving disputes that could derive from the application of the model, as its function is to interpret or clarify the provisions of the model agreement. In fact, this commentary has repeatedly led to alterations in the interpretation and application of such agreements.

Using the Commentaries on the OECD model agreement is common practice when interpreting conventions (even though there is no clear legal basis for their interpretive application) as they form part of the preparatory work for the convention. Perhaps the circumstances in which greatest reservations concerning the application of such a commentary can be put forward occur when the agreement signed does not follow the model agreement.

Therefore, in practice, the Commentaries are very important and their interpretations are applied by tax authorities and national courts. In cases when a state differs from the commentary's interpretation in order to safeguard fiscal sovereignty, a note is introduced into the Commentary or a reservation is added to the Model Double Taxation Convention (in practice many reservations and notes are introduced and this reflects the importance of the commentary).

In the last few years, the Commentaries have also been reviewed by the OECD's Committee on Fiscal Affairs, which has incorporated modifications.

Both the Model Double Taxation Convention and its Commentaries have been classified as soft law, as the OECD itself has considered them to be recommendations. They are therefore provisions that are not legally binding and their function is to prevent negative taxation conflicts (no taxation by any state) or to help settle positive conflicts (international double taxation).

3) Content of the Model Double Taxation Convention

The OECD model convention is **structured** based on the following chapters: sphere of application of the agreement, that is, taxes included (articles 1 and 2); general definitions: definition of *resident* and *permanent establishment* (articles 3 to 5); taxation of income: income from real estate, business profits, maritime shipping, associate enterprises, dividends, interest, royalties, capital gains, independent work, dependent work, directors' fees, artists and sportspeople, pensions, government service, students and other income (articles 6 to 21); taxation of capital (article 22); methods for preventing double taxation (article 23); special provision: principle of non-discrimination, amicable pro-

ceedings, exchange of information, diplomatic agents, territorial extent (articles 24 to 28) and final provisions: entry into force and abrogation (articles 29 and 30).

Without prejudice to the special features of the different agreements, the **treatment** generally received by the different **types of income** is as follows:

Recommended reading

J. M. Vallejo Chamorro; M. Gutiérrez Lousa (2002). "Los convenios para evitar la doble imposición: análisis de sus ventajas e inconvenientes". *Documents of the Institute of Fiscal Studies* (num. 6).

a) Business profits. Business profits are usually subject to taxation in the taxpayer's country of residence unless they are obtained through permanent establishment, in which case they are taxed in Spain.

Article 7 of the Convention between Spain and the United States

By way of example, article 7 (concerning business profits) of the Convention between Spain and the United States for the avoidance of double taxation and the prevention of tax evasion with respect to taxes on income, signed 22 February 1990, is transcribed here:

"1. The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on or has carried on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on or has carried on business as aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall be in each Contracting State be attributed to that permanent establishment the business profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.

3. In determining the business profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including research and development expenses, interest, and other similar expenses and a reasonable amount of executive and general administrative expenses, whether incurred in the State in which the permanent establishment is situated or elsewhere.

4. No business profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

5. For the purposes of this Convention, the business profits to be attributed to the permanent establishment shall include only the profits or losses derived from the assets or activities of the permanent establishment and shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where business profits include items of income which are dealt with separately in other Articles of the Convention, the provisions of those Articles shall not be affected by the provisions of this Article."

b) Professional activities. This type of income is taxed in the country where the taxpayer resides, except that obtained through a fixed base, which is taxed in Spain.

Article 14 of the convention between Spain and Germany

By way of example, article 14 (concerning professional activities) of the Convention between Spain and Germany to avoid double taxation and prevent income tax evasion, published in the *Spanish Official State Gazette* of 8 April 1968, states:

"1. The income obtained by a resident of a contracting state for the provision of professional services or the exercise of other similar independent activities may only be subject to taxation in this state if the resident does not have a fixed base for the exercise of his/her activity in the other contracting state. If he/she has such a fixed base, this income may be subject to taxation in the other state, but only insofar as it is appropriate to attribute the income to the fixed base.

2. The expression 'professional services' particularly includes scientific, literary, artistic, educational and teaching activities exercised independently, as well as the independent activities of doctors, lawyers, engineers, architects, dentists and accountants."

c) Artistic and sporting activities. Normally, income for artistic and sporting activities carried out on Spanish territory is taxed in Spain. However, the different agreements include particular features in relation to this type of income.

Article 14 of the convention between Spain and France

By way of example, article 14, concerning income and wealth tax, of the Convention between Spain and France to avoid double taxation and prevent income tax evasion, **signed 10 October 1995**, states:

"1. Notwithstanding the provisions of articles 14 and 15, the income of a resident of a contracting state obtained through exercising his/her personal activity in the other contracting state as a showbusiness artist; actor in the theatre or films or on radio or television; musician, or sportsperson, may be subject to taxation in that other state.

2. Notwithstanding the provisions of articles 7, 14 and 15, when the income deriving from the activities exercised by an artist or sportsperson, personally and in that capacity, is apportioned not to the artist or sportsperson but to another person, this income may be subject to taxation in the contracting state in which the artist's or sportsperson's activities are carried out.

3. Notwithstanding the provisions of section 1 and articles 14 and 15, the income deriving from the activities exercised, personally and in that capacity, by a showbusiness artist or sportsperson resident in a contracting state in the other contracting state may be subject to taxation in the first state only when such activities carried on in the other state are largely financed by public funds from the first state, its territorial bodies or its organisations under public law.

4. Notwithstanding the provisions of section 2 of articles 7, 14 and 15, when the income deriving from the activities exercised personally and in that capacity by a showbusiness artist or sportsperson who is resident in a contracting state in the other contracting state are apportioned not to the artist or sportsperson but to another person, this income may be subject to taxation in the first contracting state but only when this other person is financed principally by public funds from this other state, its territorial bodies or its organisations under public law."

Example

Mr. Gómez, a resident in France, a state with which Spain has signed a convention to prevent double taxation, receives 40,000 euros for a music concert held in Alicante.

In accordance with article 17.1 of the Tax Treaty between France and Spain to prevent double taxation, the 40,000 euros received by Mr. Gómez may be taxed in Spain because, as can be deduced from the explanation, the concert has not been financed with public funds from France.

d) Directors. All income received as a member of the board of directors of a company resident in Spain (shareholdings, attendance expenses, etc.) will be taxed in Spain.

By way of example, article 16 (concerning directors' fees) of the Tax Treaty between Spain and Australia for the avoidance of double taxation and the prevention of tax evasion with respect to taxes on income protocol, signed in Canberra on 24 March 1992, is transcribed here:

"Directors' fees and similar payments derived by a person who is a resident of one of the Contracting States in the person's capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other state."

e) Income from real estate. The conventions provide that income from real estate is taxed in the state where it is located. As a result, income deriving from real estate in Spain is taxed under Spanish regulations.

Article 6 of the agreement between Spain and Italy

By way of example, article 6 (concerning income from real estate) of the Convention between Spain and Italy to avoid double taxation and prevent tax evasion, signed in Canberra on 8 September 1977, states:

"1. Income from real estate, including income from farming and forestry, may be subject to taxation in the contracting state in which the real estate is located.

2. The expression 'real estate' will be defined in accordance with the laws of the contracting state in which the assets in question are located. In all cases, this expression will include accessories, stock and equipment for farms and forestry operations, as well as the rights to which the provisions of private law relating to holdings apply. 'Real estate' is also considered to include the usufruct of real estate and the right to receive variable or fixed royalties for the exploitation or concession of exploitation of mineral deposits, springs and other natural resources. Boats, ships and aircraft are not considered to be 'real estate'.

3. The provisions of paragraph 1 apply to income deriving from direct use, leasing or share farming, disposition and any other form of exploiting the real estate.

4. The provisions of paragraphs 1 and 3 also apply to income deriving from the real estate of a company and the income from real estate used to exercise an independent profession."

f) Dividends, interest and royalties. The criterion applicable in these cases is shared taxation between the source state and the state where the taxpayer resides. As a result, if the source state is Spain, this income is taxed in Spain, but limited to the tax rate indicated in the agreement.

Royalties are the income paid to the holder of copyright, patents or registered trademarks. They are currently one of the sources of income that cause most interpretation disputes as they include new assets, such as computer programs, or intangible ones, such as *know-how*.

Article 10 of the convention between Spain and Britain

By way of example, article 10 (concerning dividends) of the Convention between Spain and Britain for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital, signed on 21 October 1975, is quoted below:

Dividends derived from a company which is a resident of Spain by a resident of the United Kingdom may be taxed in the United Kingdom. Such dividends may also be taxed in Spain, and according to the laws of Spain, but where such dividends are beneficially owned by a resident of the United Kingdom the tax so charged shall not exceed:

"10 per cent of the gross amount of the dividends if the beneficial owner is a company which controls directly or indirectly at least 10 per cent of the voting power in the company paying the dividends;

In all other cases 15 per cent of the gross amount of the dividends.

Dividends derived from a company which is a resident of the United Kingdom by a resident of Spain may be taxed in Spain. Such dividends may also be taxed in the United Kingdom and according to the laws of the United Kingdom, but where such dividends are beneficially owned by a resident of Spain the tax so charged shall not exceed:

10 per cent of the gross amount of the dividends if the beneficial owner is a company which controls directly or indirectly at least 10 per cent of the voting power in the company paying the dividends;

In all other cases 15 per cent of the gross amount of the dividends.

However, as long as an individual resident in the United Kingdom is entitled to a tax credit in respect of dividends paid by a company resident in the United Kingdom, the following provisions of this paragraph shall apply instead of the provisions of paragraph (2) of this Article;

Dividends derived from a company which is a resident of the United Kingdom by a resident of Spain may be taxed in Spain.

Where a resident of Spain is entitled to a tax credit in respect of such a dividend under sub-paragraph *(b)* of this paragraph, tax may also be charged in the United Kingdom and according to the laws of the United Kingdom, on the aggregate of the amount or value of that dividend and the amount of that tax credit at a rate not exceeding 15 per cent.

Except as provided in sub-paragraph *(a)(ii)* of this paragraph, dividends derived from a company which is a resident of the United Kingdom and which are beneficially owned by a resident of Spain shall be exempt from any tax in the United Kingdom which is chargeable on dividends.

A resident of Spain who receives dividends from a company which is a resident of the United Kingdom shall, subject to the provisions of sub-paragraph *(c)* of this paragraph and provided he is the beneficial owner of the dividends, be entitled to the tax credit in respect thereof to which an individual resident in the United Kingdom would have been entitled had he received those dividends, and to the payment of any excess of such credit over his liability to United Kingdom tax.

The provisions of sub-paragraph *(b)* of this paragraph shall not apply where the beneficial owner of the dividends is a company which either alone or together with one or more associated companies controls directly or indirectly at least 10 per cent of the voting power in the company paying the dividends. For the purpose of this paragraph two companies shall be deemed to be associated if one controls directly or indirectly more than 50 per cent of the voting power in the other company, or a third company controls more than 50 per cent of the voting power in both of them.

The term *'dividends'* as used in this Article means income from shares, or other rights, not being debt-claims, participating in profits, as well as income from corporate rights assimilated to income from shares by the taxation law of the State of which the company making the distribution is a resident and also includes any other item (other than interest relieved from tax under the provisions of Article 11 of this Convention) which, under the law of the Contracting State of which the company paying the dividend is a resident, is treated as a dividend or distribution of a company.

The provisions of paragraph (1) or, as the case may be, paragraphs (2) and (3) of this Article, shall not apply where the resident of one of the Contracting States has in the other Contracting State a permanent establishment and the holding by virtue of which the dividends are paid is effectively connected with the business carried on through such permanent establishment. In such a case the provisions of Article 7 shall apply.

If the beneficial owner of a dividend being a resident of a Contracting State owns 10 per cent or more of the class of shares in respect of which the dividend is paid then paragraph (1) or, as the case may be, paragraphs (2) and (3), of this Article shall not apply to the dividend to the extent that it can have been paid only out of profits which the company paying the dividend earned or other income which it received in a period ending 12 months or more before the relevant date. For the purposes of this paragraph the term 'relevant date' means the date on which the beneficial owner of the dividend became the owner of 10 per cent or more of the class of shares in question.

Provided that this paragraph shall not apply if the beneficial owner of the dividend shows that the shares were acquired for bona fide commercial reasons and not primarily for the purposes of securing the benefit of this Article.

Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company and beneficially owned by persons who are not residents of the other State, or subject the company's undistributed profits to a tax on undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in that other State; provided that where a company which is a resident of a Contracting State has a permanent establishment in the other Contracting State it may be subjected therein to any withholding tax provided by the internal law of that other Contracting State but such tax shall not exceed 15 per cent of the distributed profits of the company attributable to the permanent establishment after payment of corporation tax on its profits."

Tax rates in agreements signed by Spain

Country	Dividends			Interest	Royalties
	General	Parent-subsidiary			
		% minimum holding	Type		
Albania	10	75/10	0/5	0/6	0
Algeria	15	10	5	0/5	7/14
Arab Emirates	15	10	5	0	(3)
Argentina:					
• Old convention	15	25	10	0/12.5	3/5/10/15
• New convention	15	25	10	0/12	3/5/10/15
Armenia	10	25	0	5	5/10
Australia	15	-	-	10	10
Austria	15	50	10	5	5
Barbados	5	25	0	0	0
Belgium	15	25	0	0/10	5
Bolivia	15	25	10	0/15	15/0
Bosnia and Herzegovina	10	20	5	0/7	7
Brazil	15	-	-	10/15	10/15
Bulgaria	15	25	5	0	0
Canada	15	-	-	15	0/10
Chile	10	20	5	5/15	5/10
China	10	-	-	10	10
Colombia	5	20	0	10	10

Source: Document *Taxation of non-residents*. Spanish tax agency website.

Country	Dividends			Interest	Royalties
	General	Parent-subsidiary			
		% minimum holding	Type		
Costa Rica	12	20	5	0/5/10	10
Croatia	15	25	0	0/8(7)	0/8(7)
Cuba	15	25	5	10	0/5
Cyprus	5	10	0	0	0
Czech Republic	15	25	5	0	0/5
Denmark(6)	15	-	0(1)	10	6
Dominican Republic	10	75	0	0/10	10
Ecuador	15	-	-	5/10	5/10
Egypt	12	25	9	10	12
El Salvador	12	50	0	0/10	10
Estonia	15	25	5	0/10	5/10
Finland	15	25	10	10	0/5
Former USSR	18	-	-	0	5
France	15	10	0	10	0/5
Georgia	10	10	0	0	0
Germany:					
• Old convention	15	25	10	10	5
• New convention	15	10	5	0	0
Greece	10	25	5	0/8	6
Hong Kong	10	25	0	0/5	5
Hungary	15	25	5	0	0
India	15	-	-	15	10/20
Indonesia	15	25	10	10	10
Iran	10	20	5	7.5	5
Iceland	15	25	5	5	5
Ireland	15	25	0	0	5/8/10

Source: Document *Taxation of non-residents*. Spanish tax agency website.

Country	Dividends			Interest	Royalties
	General	Parent-subsidiary			
		% minimum holding	Type		
Israel	10	-	-	5/10	5/7
Italy	15	-	-	12	4/8
Jamaica	10	25	5	0/10	10
Japan	15	25	10	10	10
Kazakhstan	15	10	5	0/10	10
Korea	15	25	10	10	10
Kuwait	5	10	0	0	5
Latvia	10	25	5	0/10	5/10
Lithuania	15	25	5	0/10	5/10
Luxembourg	15	25	10	10	10
Macedonia	15	10	5	5	5
Malaysia	5	5	0	0/10	5/7
Malta	5	25	0	0	0
Mexico	15	25	5	10/15	0/10
Moldova	10	25/50	5/0	0/5	8
Morocco	15	25	10	10	5/10
Netherlands	15	25/50	5/10	10	6
New Zealand	15	-	-	10	10
Norway	15	25	10	0/10	5
Pakistan	10	25/50	7.5/5	0/10	7.5
Panama	10	40/80(8)	5/10	0/5	5
Philippines	15	10	10	10/15	10/15/20
Poland	15	25	5	0	0/10
Portugal	15	25	10	15	5
Romania	15	25	10	10	10
Russian Federation	5/10/15(2)	-	-	5	5
Saudi Arabia	5	25	0	0/5	8
Senegal	10	-	-	0/10	10

Source: Document *Taxation of non-residents*. Spanish tax agency website.

Country	Dividends			Interest	Royalties
	General	Parent-subsidiary			
		% minimum holding	Type		
Serbia	10	25	5	0/10	5/10
Singapore	5(9)	10	0	0/5	5
Slovak Republic	15	25	5	0	0/5
Slovenia	15	25	5	5	5
South Africa	15	25	5	0/5	5
Sweden	15	50	10	15	10
Switzerland	15/0(10)	25/10(10)	10/0(4)	10/0(4)	5/0(5)
Taiwan	10	0)	-	10/15	5/8/15
Trinidad and Tobago	10	25/50	5/0	0/8	5
Tunisia	15	50	5	5/10	10
Turkey	15	25	5	10/15	10
United Kingdom:					
• Old convention	15	10	10	12	10
• New convention	10/15/0	10	0	0	0
United States	15	25	10	10	5/8/10
Uruguay	5	75	0	0/10	5/10
Venezuela	10	25	0	0/4.95/10	5
Vietnam	15	25/50	10/7	10	10

Source: Document *Taxation of non-residents*. Spanish tax agency website.

Country	Dividends			Interest	Royalties
	General	Parent-subsidiary			
		% minimum holding	Type		

Figures in percentages
(1) See article 10 of the Convention.
(2) See article 10 of the Convention.
(3) See article 12 of the Convention.
(4) The exemption for parent-subsidiary dividends and interest is applicable to income accrued since 01-06-2007.
(5) The exemption for royalties between associated companies is applicable to income accrued since 02-07-2011.
(6) The Convention between Spain and Denmark and its Protocol have been abrogated by Denmark (Official Spanish Government Gazette 19-11-2008). As a result, the Convention and its Protocol are no longer in force since 1 January 2009.
(7) Articles 11 and 12, see Protocol: after a period of five years from the coming into force of the Convention the rates will be 0%.
(8) See article 10 of the Convention.
(9) See article 10 of the Convention.
(10) The Protocol of 27 June 2011 amending the Convention 2011 (Spanish Official State Gazette 11-06-2013) amends the minimum shareholding percentage (which comes to be 10%) and introduces circumstances of exemption (dividends paid into a recognised pension fund or plan).

Source: Document *Taxation of non-residents*. Spanish tax agency website.

g) Income from employment. In general, the income received for a job done in Spain are taxed by the Spanish state unless the following circumstances all occur: the non-resident does not remain in Spain for more than 183 days during the year; the remuneration is paid by a non-resident employer, and this remuneration is not supported by a PE or fixed base which the employer has in Spain.

Article 10 of the Convention between Spain and Switzerland

By way of example, article 10 (relating to income from employment) of the Convention between Spain and Switzerland to prevent double taxation concerning income and property tax, published in the *Spanish Official State Gazette* of 3 March 1967, is translated into English here:

"1. Without prejudice to the provisions of articles 16, 18 and 19, wages, salaries and similar remuneration obtained by a resident of a contracting state through employment may only be subject to taxation in this state if the resident does not do the job in the other contracting state. If the job is done in the other state, the remuneration deriving from it may be subject to taxation in that state.

2. In spite of the provisions of paragraph 1, remuneration obtained by a resident of a contracting state through a job done in the other contracting state may only be subject to taxation in the first state if:

a) the employee does not remain in the other state for more than a total of 183 days, in one or more periods, during the tax year under consideration;

b) the remuneration is paid by or on behalf of a person not resident in the other state and

c) the remuneration is not supported by a permanent establishment or fixed base of the employer in the other state.

3. Notwithstanding the above provisions of this article, remuneration obtained from a job done on board a ship or aircraft involved in international traffic may be subject to taxation in the contracting state where the company's actual headquarters is based."

h) Pensions. These are treated differently depending on whether they are received through public or private employment. In the first case, they are generally taxed in the state where the pensions are paid, not in that where the taxpayer resides (however, in some conventions, if the nationality of the state of residence is taken, it is this one that taxes the pensions). In the second case (which generally includes social security pensions), they are usually taxed in the taxpayer's state of residence.

Withholding

When, under the application of the convention, the non-resident must pay tax in the state of residence, it is not appropriate to apply withholdings to the income paid in Spain. However, the payer must ask the non-resident for a certificate of residence, and present the corresponding declaration.

It is understood that a pension is public when it is received due to previous public employment exercised at all territorial levels, while a private pension would be any pension received due to previous private employment.

Article 18 of the Convention between Spain and Argentina

By way of example, article 18 (relating to pensions, retirement, annuities and maintenance) of the Convention between Spain and Argentina to avoid double taxation and prevent tax evasion concerning income and property tax, signed 21 July 1992, states:

"1. Pensions and retirement pensions paid to the resident of a contracting state may only be subject to taxation in this state.

2. The provisions of the above section shall also apply to benefits received by beneficiaries of pension funds and other alternative systems.

3. Annuities paid to the resident of a contracting state may only be subject to taxation in that state. The term *annuity* means a fixed sum that must be paid periodically at established periods throughout the life of a person or during a determined or determinable period of time in exchange for the payment of an appropriately equivalent amount in money or in notes representing it.

4. Maintenance paid to the resident of a contracting state may only be subject to taxation in that state. The expression 'maintenance' as used in this section means periodic payments made in accordance with a written separation agreement, a separation or divorce order or compulsory aid, with respect to which the recipient is subject to taxation in accordance with the laws of the state where he/she resides.

5. Periodic payment to maintain children below legal age in application of a written separation agreement, a separation or divorce order or compulsory aid, made by the resident of a contracting state to a resident of the other contracting state may only be subject to taxation in the first mentioned contracting state."

i) Student grants. In general, the amounts received by students for living costs, studies and training are exempt, whenever they come from sources located abroad.

j) Capital gains. Generally, it is the state of residence that taxes capital gains, with the exception of those deriving from the sale of real estate located on Spanish territory, which are taxed in Spain.

Article 21 of the Convention between Spain and Russia

By way of example, article 21 (concerning other income) of the Convention between Spain and Russia to avoid double taxation and prevent tax evasion concerning income and property tax and the protocol, signed in Madrid on 16 December 1998, states:

"1. The income of a resident of a contracting state, whatever his/her origin, not mentioned in the above articles of this Convention, shall be subject to taxation in that state.

2. The provisions of section 1 do not apply to income other than that deriving from real estate in the sense of section 2 of article 6, when the beneficiary of this income, a resident of a contracting state, carries out business activity in the other contracting state by means of a permanent establishment in that other state or provides independent personal services via a fixed base in that other state and the right or asset for which the income is paid is effectively linked to this permanent establishment or fixed base. In such a case, the provisions of article 7 or article 14 apply, as appropriate.

3. Notwithstanding the provisions of sections 1 and 2, the elements of the income of a resident of a contracting state not mentioned in the above articles of this Convention and originating in the other contracting state may also be taxed in that other state."

Meanwhile, the **methods of avoiding double taxation** which the state of residence must apply in accordance with the provisions of the Model Double Taxation Convention[6], are as follows:

(6)Art. 23 of the Model Double Taxation Convention

- When the source state may tax income in an unlimited way, in the same way as the state of residence, it may establish an exemption with progression system or the ordinary credit one. This is what happens for income from real estate, the ones obtained by means of a permanent establishment (except in international shipping and air transport), the ones proceeding from artistic and sporting activities, remuneration from private employment and the remuneration of directors.

- When the source state exclusively taxes income, the state of residence may apply the progressive exemption method and the full exemption method.

- In the case of dividends and interests, which may be taxed at source in a limited way, with the maximum percentages established in the convention, the state of residence applies the ordinary credit method.

Non-application of the exemption method

The exemption method does not apply if there is a discrepancy in classification between the state of residence and the source state, so that the latter does not tax the income, considering that it has not been obtained on its territory.

4. Residence for tax purposes

Residence becomes a key element in the taxation of individuals and organisations as it is an essential part of establishing the fiscal sovereignty of a state. So, the first step to find out if the circumstances of international taxation apply is to determine the person's residence.

The criteria determining residence vary from one country to another: existence of a home, carrying out business, making certain investments, or remaining on the territory for a certain significant period of time – which is the most commonly used criterion – such as 180, 182 or 183 days or six months during any period of twelve months or during the calendar year.

The classification of an individual or organisation as resident in Spain for tax purposes decisively determines his/her/its taxation:

- Thus, taxpayers who are resident in Spain, whether they are individuals or organisations, must pay personal income tax or corporation tax respectively for all their income (both that obtained in Spain and abroad).

- By contrast, taxpayers not resident in Spain, whether they are individuals or organisations, must pay income tax on non-residents for their income obtained in Spain unless there is an applicable international convention.

Residence exclusively for tax purposes

The regulations governing residence examined are exclusively for tax purposes, which means their effects cannot be extended to other areas (administrative, social security, etc.) or the reverse. It is true that, although a person may have residence authorisation or administrative residence in a state, he may not be considered as a tax resident in that state.

The Consolidated Text of the Income Tax on Non-Residents Act does not contain a definition of a non-resident for tax purposes. In fact, its article 5, relating to the figure of *taxpayer* (non-resident), refers to article 6 which, governing residence on Spanish territory, indicates that it will be determined in accordance with the provisions of article 9 of the Personal Income Tax Act and 8.1 of the Corporation Tax Act. Thus, the criteria for determining residence are different depending on whether it concerns an individual or an organisation.

From the wording of this precept, it is possible to draw three conclusions[7]:

(7) Art. 6, TRLIRN

- Firstly, this precept restricts itself to referring to the regulations governing personal income tax and corporation tax, establishing the criteria for determining habitual residence in Spain for individuals and organisations respectively.

- Meanwhile, it must be pointed out that the criteria for determining residence are different, depending on whether an individual or an organisation is concerned.

- And, finally, non-residence must be understood in the opposite sense.

4.1. The residence of individuals for tax purposes

1) The criteria for determining residence for tax purposes

An **individual** has his/her habitual residence in Spain when any of the following circumstances occur[8]:

[8] Art. 6, TRLIRN and art. 9 LIRPF.

- If he/she remains in Spain for more than 183 days during the calendar year; therefore more than half of the calendar year (half a year and one day). For the purposes of calculating this period, his/her sporadic absences are taken into account unless he/she can prove residence for tax purposes in another country.

- If the main centre or base of his/her business or economic interests (basically real estate and income) is directly or indirectly based in Spain.

On the other hand, an individual will be considered to be non-resident in Spain when he/she does not meet any of the above requirements. And, insofar as he/she obtains income in Spain, he/she will be considered as a payer of income tax on non-residents.

Concept and scope of residence for tax purposes

Concerning the concept and scope of the residence of individuals for tax purposes, the Judgment of the Supreme Court of 11 November 2009 concerning Act 44/1978, of 8 September, governing personal income tax, indicates that "on one hand, a spiritual element is required, the 'intention' to reside in a particular place. Meanwhile, there must also be a material element, actual residence". It adds that the fundamental element is the latter because "the change of residence for the 1978 tax regulation requires not only a desire to live elsewhere, but also the effectiveness of that desire. In other words, actual residence for more than 183 days in territory other than Spanish territory". So, "from the point of view of the concept of *residence* used by the legislator of 1978, a person may be resident in Spain or in another place. But what is unavoidable is that a person does not cease to be resident in Spain simply by stating that he/she has requested residence in another place if actual residence in the chosen place is not added".

1) In relation to the first circumstance, **remaining for more than 183 days**, it must be pointed out that, in principle, if the person remains in Spain for more than half year, he/she is automatically considered a resident for tax purposes. In this respect, the 183 days do not have to be consecutive.

However, as it is not easy to prove actually remaining in the territory, the criterion is established that, for calculating this period, sporadic absences (such as time on holiday abroad) will not be taken into account unless residence in another country for tax purposes is proven. This criterion that days spent by individuals outside Spain are counted as days remaining on Spanish territory may originate from there being no desire to perpetuate these sporadic absences in time or no intention to change residence. This is the basis for the fallacy that people remain in Spain despite their temporary or sporadic absence from the country.

Calculation of residence period

To calculate the residence period, temporary stays in Spain resulting from obligations contracted with Spanish public administrations in unremunerative cooperative, cultural or humanitarian agreements are not taken into account.

Concept of sporadic absence

However, neither the Income Tax on Non-Residents Act nor the regulations clarify what is understood by sporadic absences. The criterion is determined by the pronouncements of the Directorate General of Taxation, including the query to the Directorate General of Taxation 320-00, of 23 February 2000, not associating temporary absence with a time limit.

Consequently, once a significant presence on Spanish territory has been shown, the **calculation period** opens and it is not frozen due to sporadic absences unless residence in another country for tax purposes can be proven. In other words, it is not sufficient for the taxpayer to allege that he/she has not resided in Spain for more than 183 days during the year; he/she must also certify residence for tax purposes in another state.

Recommended reading

See the Decision of the Directorate General of Taxation of 4 June 1992.

In the case of countries or territories classified in the regulations as **tax havens**, the tax administration may also demand that the person proves he/she stays in the tax haven for 183 days in the calendar year. If the subject cannot prove he/she actually remains in the tax haven for more than 183 days, sporadic absences (the time he/she has remained in the tax haven) will be considered as time present in Spanish territory, in addition to proven stays in Spain.

Evidence

For the purposes of evidence, it is little use alleging the existence of certain energy consumption (electricity, gas, water or telephone) in a tax haven, because it will be difficult to guarantee that this consumption has actually been made by the owner of the property.

2) In relation to the second circumstance, the **main centre or base of its business or economic interests**, this is a complementary measure closing off the residence period criterion, as actual stays are difficult to monitor, particularly when there is no physical border control. As a result, regardless of the time a person remains on Spanish territory, he/she is considered to be resident in Spain if he/she has the main centre of his/her economic interests there.

However, it is a concept with imprecise boundaries, not specified in the regulations, being like a ‘blank cheque’ that allows the administration to apply the tax to anyone who maintains economic relations with Spanish territory or those who live there. Some terms, such as ‘economic interest’ or ‘principal centre’ may give rise to interpretation problems, as they are poorly defined.

2) Assumptions concerning residence for tax purposes

In addition, Spanish tax regulations establish two assumptions concerning the residence of individuals for tax purposes.

a) Firstly, it is assumed[9], unless there is proof to the contrary, that a taxpayer has his/her habitual residence in Spain when, in accordance with the above criteria, **his/her spouse (if not legally separated) and dependent children below legal age habitually reside there**.

(9)Art. 9.1.b LIRPF.

The following observations can be made concerning the wording of this criterion:

- Firstly, all the children under age dependent on the taxpayer must be taken into account.
- Secondly, the de facto separations or common-law couples so common nowadays are not considered.
- Thirdly, nor do other forms of family unit recognised in the Personal Income Tax Act itself apply, such as taxpayers supporting children who are incapacitated but of legal age or legally subject to extended or rehabilitated parental powers; cases of legal separation, or the non-existence of matrimonial links with children under legal age or incapacitated but of legal age.
- Fourthly, there is an assumption of residence in Spain for tax purposes; if the taxpayer provides evidence proving his/her residence abroad, the assumption is destroyed (*iuris tantum* assumption).
- And, fifthly, the forms of evidence with which the taxpayer can destroy this assumption of residence in Spain are not established.

No specification of the forms of evidence to disprove the assumption

Faced with this failure to specify the forms of evidence for disproving the assumption, some believe that a certificate of residence for tax purposes issued by the tax authorities of a country demanding a tax similar to the Spanish one must be provided (which is how the Spanish tax administration sees it), while according to another doctrine it is not necessary for such accreditation to be related to tax as long is it demonstrates residence in another country.

Example

Mr. Gutiérrez, of French nationality, is married to a Spanish woman and has a flat in Valencia. His wife habitually lives in this flat while he, for work reasons, uses it only at weekends, as during the week he moves between France and Germany. Mr. Gutiérrez does not have any administrative certification of residence.

Given the non-existence of proof of habitual residence in another country, Mr. Gutiérrez will be considered to be resident in Spain, as his wife, who is not legally separated from him, lives in Spain and he has not disproved the effects of the assumption in article 9.1 of the Personal Income Tax Act and has not accredited residence for tax purposes in another country.

b) Meanwhile, it must be pointed out[10] that individual Spanish nationals who **prove new residence in a tax haven** will remain taxpayers for personal income tax (therefore paying tax in Spain for their entire worldwide income) in the tax period including the change of residence and the subsequent four periods. The taxes paid in the new country of residence will be deductible from Spanish taxation with the limitations established in this respect by Spanish personal income tax regulations.

(10)Art. 8.2 LIRPF.

Example

Mr. Pérez, a well-known Spanish international opera singer, moved his residence to the Bahamas in 2005.

As the Bahamas is considered a tax haven (RD 1080/1991, of 5 July, including a list of the countries or territories considered as tax havens), Mr. Pérez will remain a taxpayer for personal income tax in 2005 and for the following four years (art. 8.2 Personal Income Tax Act).

This provision, known as the *Arantxa clause*, consists of a *iuris et de iure* assumption that does not allow evidence to the contrary. Ultimately, it constitutes a provision against the delocation of residence for tax purposes to territories with tax privileges, and is one of the few circumstances in which the criterion of nationality is taken into account.

Fiscal quarantine

This assumption constitutes a kind of 'fiscal quarantine' because of the risk of fiscal anomaly or disorder assumed by the legislators to affect those who are in contact with a tax haven.

Extended residence

In these circumstances, we speak of extended residence. The tax applied during this extension is known as *training tax*. It is not a different tax in Spain (in other countries it can be); it is the same tax as applied to residents and it is applied to the non-resident during the extended residence period.

In this sense, it must be pointed out legal opinion is divided over this provision, as it is considered by one doctrine as a *iuris et de iure* assumption, while, for another doctrine, it is a substantive rule extending residence.

The criticisms made of this regulation are that it does not exclude temporarily expatriate workers from its sphere of application, as well as the fact that it exclusively affects Spanish taxpayers, so its application can be evaded simply by giving up Spanish nationality. The provision can also easily be evaded with a change of residence to another state not included in this anti-tax haven clause before then moving to effective residence in a tax haven.

Failure to allow contrary evidence

Meanwhile, it should be stressed that not allowing contrary evidence (of an effective link with a territory or the lack of links with Spain, or that taxes have actually been paid in the new country of residence), and the consideration that any change of residence to a tax haven is for the purposes of tax evasion, could constitute a defect of unconstitutionality, because they attack the principle of economic capacity.

However, this provision is not applied to individuals resident in Andorra who prove that they are paid workers, provided they meet certain requirements[11]. In any case, art. 8.2 of the Personal Income Tax Act is no longer applied in the case of Andorra, as it is no longer considered to be a tax haven.

(11)Additional provision 21, LIRPF

A table is included below offering an example of each of the circumstances included in articles 8.2, 9, 10 and 93 of the Personal Income Tax Act.

Habitual residence on Spanish territory

Assumptions	Examples
Art. 9 Personal Income Tax Act: "It will be assumed, without evidence to the contrary, that a taxpayer has his/her habitual residence in Spain when, in accordance with the above criteria, his/her spouse (if not legally separated) and dependent children below legal age habitually reside there.	A sales representative with French nationality travels constantly all over Europe to carry out his commercial operations, so he spends only his summer holidays in Spain, where his wife and children under legal age live.
Art. 10.1 Personal Income Tax Act: "For the purposes of this Act, people of Spanish origin who have their habitual residence abroad, together with their spouses if not legally separated and children under legal age, will be considered to be taxpayers if they are: a) Members of Spanish diplomatic missions, including both the head of the mission and the members of the mission's diplomatic, administrative, technical or services staff."	The Spanish ambassador in Berlin performing his duties as head of the Spanish diplomatic mission in Germany, was appointed to the post two years ago. At that time, he moved to Germany, taking his wife with him. Both the ambassador and his wife are considered to be taxpayers for Spanish personal income tax.
Art. 10.1.b Personal Income Tax Act: "Members of Spanish consular offices, including the heads of these, and civil servants or services staff attached to them, with the exception of honorary vice-consuls or honorary consular agents and their dependents."	The Spanish consul in Milan performs the duties of head of the Spanish consular office in that city. When he was appointed to occupy this post four years ago, he moved to Milan with his wife. Both the Consul and his wife are considered to be taxpayers for Spanish personal income tax purposes.
Art. 10.1.c Personal Income Tax Act: "Holders of official posts or jobs with the Spanish state, such as members of accredited permanent delegations and representations before international bodies or forming part of delegations and observer missions abroad."	The Spanish Ambassador to the United Nations, in New York, was appointed to occupy the post three years ago. The ambassador is considered to be a taxpayer for the purposes of Spanish personal income tax.
Art. 10.1.d Personal Income Tax Act: "Active civil servants working abroad in an official post or job that is not diplomatic or consular."	A member of the armed forces posted to the Spanish embassy in Brussels is considered to be a taxpayer for the purposes of Spanish personal income tax.
Art. 10.2 Personal Income Tax Act: "The provisions of number 1. above shall not apply: a) When the people referred to in number 1. of this section are not active civil servants or holders of official posts or jobs and had their habitual residence abroad prior to acquiring any of the conditions mentioned."	A security manager at the Spanish embassy in Beijing forms part of the workforce at that diplomatic mission in China. When he began working for the embassy he was already living in Beijing. Whether or not he has Spanish nationality, the security manager will not be considered a taxpayer for Spanish personal income tax.

Assumptions	Examples
Art. 10.2.b Personal Income Tax Act: "In the case of spouses who are not legally separated or children below legal age, when they had their habitual residence abroad prior to the acquisition by their spouse, father or mother of the conditions set out in number 1. of this section."	The Spanish ambassador in Rabat marries a doctor with Spanish nationality who already lived in Morocco. The ambassador is considered to be a taxpayer for Spanish personal income tax, but his wife is not because she had her habitual residence in that country before her husband was appointed ambassador.
Art. 8.2 Personal Income Tax Act: "Individuals of Spanish nationality who prove a new residence for tax purposes in a country or territory classified under the regulations as a tax haven will not lose their condition as taxpayers for this tax. This rule shall apply during the tax period in which the change of residence is made and the four subsequent tax periods."	A famous Spanish tennis player, fed up with the enormous taxes she has to pay in her country, decides to move her habitual residence to Andorra. As she is a Spanish national and is moving to a tax haven, she will continue to be considered as a taxpayer for Spanish income tax purposes in the period when the change is made and for the next four tax periods.
Art. 9.2 Personal Income Tax Act: "Under reciprocity, foreign nationals with their habitual residence in Spain shall not be considered as taxpayers when this is the result of one of the circumstances established in section 1 of article 10 of this Act and it is not appropriate to apply the specific rules deriving from the international treaties to which Spain is party."	The French ambassador in Madrid, performing the duties of head of the French diplomatic mission in Spain, was appointed to occupy the post for three years. At that point, he moved to Spain, taking his wife with him. Under reciprocity, neither the French ambassador nor his wife are considered to be taxpayers for Spanish personal income tax.
Art. 93 Personal Income Tax Act: "Individuals who acquire residence for tax purposes in Spain as a result of moving to Spanish territory may opt to pay personal income tax or income tax on non-residents, maintaining their condition as taxpayers for the purposes of personal income tax for the tax period during which the change of residence is made and for the subsequent five tax periods, when a series of circumstances all occur."	An American IT expert has worked with an employment contract from January 2004 to August 2004 at the Spanish subsidiary of the American computer company he works for. Throughout the period, he has remained on Spanish territory without going abroad and he had never been to Spain before coming to work for the Spanish subsidiary. As he has stayed on Spanish territory for more than 183 days during the calendar year, he is subject to Spanish personal income tax, but he may opt to pay income tax on non-residents with proportional and non-progressive tax rates.

3) Accreditation of residence for tax purposes

If there is no certificate of residence for tax purposes approved by a supranational institution, the Spanish tax administration generally applies restrictive criteria when it comes to accepting proof of habitual residence in another state or territory, despite the existence of a principle of freedom of evidence in tax matters.

Proof of residence for tax purposes must be made with a **certificate issued by the competent tax authority** from the country involved (valid for one year) certifying that the taxpayer has paid a similar tax to the one demanded in Spain and resides in that other state.

For these purposes[12], a local census certificate or bills for water, gas or electricity consumed are not accepted, as people do not always have their residence for tax purposes in the place where they appear on the local census and these bills for consumption do not necessarily mean that the consumption has been made by the person named on them.

(12)Decision of the Central Economic and Administrative Court, 12 March 2004.

By contrast, when it comes to the Administration proving the taxpayer's residence[13], the use of their VISA card, dates of contracts made in Spain or the properties the taxpayer has on Spanish territory are considered sufficient.

(13)Decision of the Central Economic and Administrative Court of 8 October 1999.

To conclude, it must be pointed out that an individual will be resident or non-resident **during the whole calendar year** for the purposes of personal income tax and income tax on non-residents, as a change of residence does not interrupt the tax period, except in the case of death. Spanish regulations therefore do not allow fragmentations of tax periods due to changes of residence.

If a taxpayer taxpayer changes their residence, in the sphere of personal income tax, all tax pending apportionment must be integrated into the taxable amount for the last period for which a personal income tax return has to be made. The corresponding additional tax return will therefore be presented, without penalty, late payment interest or any surcharge, within a period of three months, from when the taxpayer loses their condition due to change of residence[14].

(14)Art. 14.3 LIRPF and art. 63 RIRPF.

In addition, both for personal income tax and income tax on non-residents, the possibility is established of deducting the amount withheld and advance payments made for both taxes from the tax payable due for each of them.

Exit tax and the European Union

In relation to this provision, it must be pointed out that some countries establish an exit tax on a resident who moves his/her residence abroad. This tax is charged on latent capital gains (the difference between the purchase value and the market value) at the time when the taxpayer moves his/her residence abroad (the latent capital gains taxed are normally only those relating to majority holdings in companies).

In its judgments of 12 March 2004 and 7 September 2006, the European Court of Justice stated that these exit taxes are incompatible with freedom of establishment as, although they do not prevent the transfer of residence to another EU Member State, they are an important deterrent measure because, if residence is maintained, the tax does not accrue until the point when sale takes place.

Spanish regulations do not include an exit tax as such, but article 14.3 of the Personal Income Tax Act orders that all income remaining to be apportioned is included in the taxable amount corresponding to the last tax period that must be declared for the tax, which could constitute a breach of the requirements deriving from freedom of establishment (the European Commission has presented an appeal before the Court of Justice on this matter).

4) Residence in conventions to prevent double taxation

In Double Taxation Conventions, residence is fundamental, as they apply to people who are resident in one or more of the contracting states.

To define a person as resident of a state, conventions to prevent double taxation signed by Spain refer to each state's domestic legislation. Consequently, if, in accordance with the domestic regulations of the contracting states, the person is only considered a resident of only one of them, this will be the residence taken into consideration regardless of the apportionment criteria used.

However, the conventions affect the determination of residence for tax purposes in a double sense: firstly because they limit the effects of the treaty to people or organisations resident for tax purposes in each of the contracting states and secondly because they establish specific rules to solve possible double residence conflicts.

In particular, as has just been mentioned, the OECD Model Double Taxation Convention[15] refers to each contracting state's internal regulations. The criteria for determining residence for tax purposes are therefore those established in each state.

(15)Art. 4 of the OECD Model Convention.

However, as each state can establish different criteria to attribute residence for tax purposes to an individual, or states can make different interpretations of the same criterion, a person can be considered a resident by the internal regulations of two or more states, which sometimes ends up causing situations of double taxation. Because of this, the different model conventions include a series of criteria to determine residence, simply for the purposes of applying the provisions of the convention to resolve these situations.

Under the provisions of article 4.1 of the OECD's Model Double Taxation convention, the expression "resident of a contracting state", for the purposes of the model convention, means "any person who, under the laws of that state, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature".

However, this precept continues by pointing out that the following are not considered the residents of a state for the purposes of the convention: "any person who is liable to tax in that state in respect only of income from sources in that state or capital situated therein". The purpose of this provision is not to exclude residents of countries that apply the source criterion, as the Commentary on the Model clarify, but rather people subject to tax exclusively under the source criterion.

In particular, the criteria established in article 4.2 of the OECD's Model Double Taxation convention to prevent a person being considered a resident in two states are as follows:

- The person will be a resident of the state where he has a permanent home available to him/her, regardless of whether it is owned, rented or held by any other title (including subletting). It must be a permanent home or with the intention that it should be permanent, not just for temporary or holiday use.

- If a person has a permanent home available in both states, he/she will be considered a resident of the state where he has closest personal and economic relations (centre of vital interests). For these purposes, the person's family and social relationships, the headquarters of his/her business, etc. must be taken into consideration.

- If determination by this method is not possible, he/she will be considered a resident of the state where he/she habitually lives. This means that he/she will be considered a resident of the state where he/she remains for most time. Stays of any kind (including in hotels) for continuous and discontinuous periods will be taken into account.

- If he/she lives habitually in both states or in neither of them, he/she will be considered to be a resident of the state where he/she is a national. In this case, nationality acts as an indication, in the absence of better ones, of the state with which the person maintains the strongest personal and economic relationships.

- If, finally, he/she is a national of both states or neither of them, the competent authorities will resolve the case by mutual agreement.

Article 4 of the Convention between Spain and the United States to prevent double taxation and tax evasion

By way of example, article 5 (relating to residence) of the Convention between Spain and the United States to avoid double taxation and prevent tax evasion with respect to taxes on income, signed on 22 February 1990, is transcribed here:

"1. For the purposes of this Convention, the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation, or any other criterion of similar nature, provided, however, that this term does not include any person who is liable to tax in that State in respect only of income from sources in that State.

2. Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:

(a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interests);

> (b) if the State in which he has his center of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
>
> (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
>
> (d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.
>
> 3. Where by reason of the provisions of paragraph 1, a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavor to settle the question by mutual agreement and determine the mode of application of the Convention to such person. If the competent authorities are unable to make such a determination, the person shall not be treated as a resident of either Contracting State except for the purposes of payments of such person covered by paragraphs 1 through 4 or Article 10 (Dividends), Article 11 (Interest), and Article 12 (Royalties)."

In accordance with the Commentary on the OECD Model Double Taxation Convention, the facts that must be taken into account when it comes to considering the criteria mentioned relate to each period when double residence occurs (which may be shorter than a calendar year). However, Spain has formulated an observation in this respect, as, in accordance with Spanish domestic legislation, the residence of individuals is necessarily predicated on the whole calendar year and it is not possible to conclude a tax period due to change of residence. Because of this, residence must be determined with respect to the whole year, through an amicable agreement.

Proof of residence, in accordance with the general rules of the burden of proof, corresponds to the state that intends to tax worldwide income. However, if the individual wants to claim residence in another state, he/she may prove residence in that other state using any form of evidence, although in administrative practice only a certificate from the competent tax authorities is accepted.

4.2. The residence of organisations for tax purposes

1) Criteria for determining residence for tax purposes

Residence in Spain of an **organisation** is acquired when one of the following criteria occurs[16]:

- It has been incorporated in accordance with the Spanish law.
- It has its registered offices on Spanish territory.
- It has its effective head office on Spanish territory. For these purposes, it is considered that an organisation has its effective management base in Spanish territory when the management and control of all its activities are based there.

(16) Art. 6 TRLIRNR and art. 8 Corporation Tax Act.

On the other hand, an organisation will be considered non-resident in Spain when it does not meet any of the above requirements.

Use of the **effective head office** criterion is intended to prevent the delocation of income relating to activities actually managed in Spanish territory, regardless of the formal appearance used to achieve the delocation of such income.

The tax administration **may assume** that an organisation based in a country or territory with no taxation is resident in Spanish territory when its main assets consist, directly or indirectly, of goods located or rights complied with or exercised in Spanish territory or when its main activity is developed there, unless the organisation proves that its effective management and administration take place in that other country or territory and the constitution and operation of the organisation correspond to valid economic or substantial business reasons, other than the simple management of securities or other assets.

If a change of residence takes place, the **tax period ends** when this change takes place (art. 27.2.b Corporation Tax Act), unlike the procedure we have seen in the case of individuals. There is therefore no waiting until the end of the calendar or business year.

Meanwhile, the Corporation Tax Act[17] establishes a **special valuation rule** in these cases, according to which the difference between the normal market value and the fiscal value of the assets belonging to an organisation resident in Spanish territory that moves its residence outside it must be included as taxable income, unless such goods keep connected with a PE in Spain.

(17)Art. 19.1 Corporation Tax Act.

And, as with the case of individuals, the residence in a particular state for tax purposes of organisations must be proved with a certificate issued by the tax authority, which is valid for one year.

2) Residence in the OECD Model Double Taxation Convention

The OECD considers the effective management base to be the place where the organisation's executive decision-making centre is based so, without a clear location of the board of directors or management, the effective management base will be in the place where the key management and substantial business decision-making for the company are, which will generally coincide with the place where the most highly qualified staff are.

However, in the context of a globalised economy and given the level of virtualisation or organisations, the importance of the physical location of the board of directors is called into question. For this reason, the reform of this OECD criterion is currently in the study phase.

Activities

Case studies

1. Provide an outline of the rules for dividing tax powers included in the Convention between Spain and Argentina currently in force. Depending on the type of income established in the Convention, you must indicate whether the option to tax is attributed to the state of residence, the source state or shared between both states and, as appropriate, the taxation limits contemplated for certain incomes in the source state (articles 6 to 21 of the aforementioned Convention).

2. Determine whether the following people or organisations have their residence for tax purposes in Spain in response to the issues raised in each case:

a) A well-known Spanish tennis player has spent a total of nine months abroad for professional reasons, playing various tournaments. He has lived in Spain for the rest of the year, in his house in Barcelona. Is he a resident of Spain for tax purposes?
b) An organisation is established in accordance with Spanish law, but has its effective management base in another state. One of the criteria used by this state to determine the residence of organisations is precisely that of the effective management base. Between this state and Spain there is a Convention to prevent Double Taxation which, in its article 4, indicates that when an organisation is resident in both states it will be considered to be a resident exclusively in the contracting state where its effective management base is. Will this organisation be resident in Spain for tax purposes?
c) Mr. Gómez, a Mexican national and resident in Spain for tax purposes, has moved his residence to Gibraltar for exclusively professional reasons. Must he pay personal income tax in Spain even though his residence for tax purposes is in Gibraltar? What if he was a Spanish national?
d) Belize is a territory with low or no tax on the Caribbean coast of Central America. The company Secure Transactions, Investment Holding is resident in Belize for tax purposes. It is an off-shore banking company responsible for the management and administration of the securities of Spanish companies. Is this company subject to Spanish income tax?

Self-evaluation

1. Double international taxation occurs when…

a) the same state taxes the same income twice under different headings.
b) the same income is taxed by two different states.
c) two taxpayers pay tax in different ways for obtaining similar income.

2. If an organisation has its effective management headquarters in Spain, in accordance with the Corporation Tax Act and without prejudice to the provisions of the conventions to prevent double taxation, it will be considered to be resident in Spanish territory…

a) if it has also been incorporated in accordance with Spanish law.
b) if it also has its registered offices in Spanish territory.
c) although it has not been incorporated in accordance with Spanish law and does not have its registered offices in Spanish territory.

3. Mr. Ordóñez, a Spanish national, has moved to Monaco for work reasons and has lived and worked there for more than two years. He visits Spain only for one week at Christmas and three in summer. Mr. Ordóñez…

a) will not be considered to be resident in Spain for tax purposes because he does not remain on Spanish territory for more than 183 days.
b) does not lose the status of taxpayer for the purposes of personal income tax for the tax period during which he moved to Monaco or the subsequent four tax periods.
c) will not be subject to Spanish personal income tax provided he can prove he is a resident of Monaco for tax purposes.

4. A golfer who is resident in Spain for tax purposes has won a prize in a tournament held in Abu Dhabi. Can Spain tax income obtained in the United Arab Emirates?

a) No, because it is income from a foreign source.
b) No, because the Convention to prevent Double Taxation between Spain and the United Arab Emirates indicates that the income of artists and sportspeople is taxed only in the state where it is obtained.

c) Yes, but Spain must accept a deduction of the tax paid by the golfer in the United Arab Emirates.

5. The company IBM has its parent company in the U.S. and operates in Spain via a subsidiary. The profits obtained by IBM's Spanish subsidiary…

a) will be income obtained in Spain by a non-resident with a permanent establishment.
b) will be income obtained in Spain by a non-resident without a permanent establishment.
c) will be income obtained by a company with residence for tax purposes in Spain and subject to corporation tax.

6. Ms. Fernández, a Spanish national living in Vienna since 1995, is indefinitely contracted in 2012 by the Spanish embassy in Austria for translation and interpreting work at various receptions and cultural events organised by the diplomatic mission. Ms. Fernández…

a) will not cease to be a resident in Austria for tax purposes.
b) will not cease to be a resident in Austria for tax purposes, but, at the same time, will come to be considered as a resident of Spain for tax purposes.
c) will come to be considered a resident of Spain for tax purposes.

7. Conventions to prevent double taxation…

a) refer to both direct and indirect taxation.
b) refer to direct taxation.
c) refer to indirect taxation.

8. In the majority of conventions to prevent double taxation, the two criteria used in order to apportion tax sovereignty are…

a) the origin of income and residence.
b) nationality and the origin of income.
c) nationality and residence.

9. In the OECD Model Double Taxation Convention, dividends and interest pay tax…

a) exclusively in the country of residence.
b) exclusively in the source country.
c) shared between the source state and the state of residence.

10. Knowing the tax paid in the source country is irrelevant…

a) in the full exemption method.
b) in the exemption with progression method.
c) Both answers are correct.

Answer key

Case studies

1.

The Convention between the Kingdom of Spain and the Republic of Argentina to avoid double taxation and prevent tax evasion concerning income and property tax currently in force was issued in Buenos Aires on 11 March 2013 (Spanish Official State Gazette, 14 January 2014).

Articles 6 to 21 include classes of income and basically follow OECD criteria concerning the distribution of taxation power. However, before beginning to analyse the apportionment rules, we must remember that when the double taxation convention indicates that income "**can be subject to taxation in a state**" this does not exclude the taxation rights of the other state, so, in such cases, income can be taxed both at source and in the country of residence. By contrast, when the double taxation convention intends to apportion the right to tax exclusively to one state, it usually indicates that the income in question "**may be subject to taxation only**" in this state.

The diagram of the apportionment rules could be drawn as follows:

(Note: we omit article 9 on associated companies because we consider that it is not a rule for the apportionment of taxation powers but rather for the assessment of operations linked to market prices and for the correction of double taxation in such cases.)

Income from real estate (article 6). The income that a resident of a contracting state obtains from real estate located in the other contracting state may be subject to taxation in that other state. This means it may be taxed both in the state of residence and in the state where the real estate is.

Business profits (article 7). The business profits of a company from a contracting state may be taxed only in that state unless the company carries on business in the other contracting state through a permanent establishment located there. If the company carries on its business in this way, the company's profits may be subject to taxation in the other state, but only insofar as they are apportioned to this permanent establishment. The general criterion is applied under which the power to tax such income corresponds exclusively to the state of residence, unless the profits are obtained in the other state through a permanent establishment, in which case the source state may also tax this income.

Shipping and air freight (article 8). Profits from operating ships and aircraft in international transport may be subject to taxation only in the state in which the company's effective head office is located; in other words, they are subject to tax only in the state of residence.

Dividends, interest and royalties (articles 10, 11 and 12). For unearned income, taxation is shared between the state of residence and the source state. However, the source state's power of taxation cannot exceed the limits in the double taxation convention: dividends (10% for companies with a minimum holding or 15% in the remaining cases); interest (12%) and royalties (3%, 5%, 10% or 15% depending on the type of intangible). So, for example, if a resident in Argentina obtains dividends in Spain without a permanent establishment, the tax rate of 21% established in the Income Tax on Non-Residents Act cannot be applied and the tax rate will be limited to 10% or 15% in accordance with the limits in the Convention.

Capital gains (article 13). Various classes of capital gains are distinguished: 1. Capital gains on real estate: these may be subject to taxation in both states. 2. Gains deriving from the sale of movable property forming part of a permanent establishment: these may be subject to taxation in both states, both where the company is resident and where it has a permanent establishment. 3. Sales of ships or aircraft for international traffic: exclusively subject to taxation in the state of residence where the effective management base is located. 4. Sale of shares when more than half their value derives from real estate: this may be subject to taxation in both states, both that of residence of the recipient of the gain and that where the real estate is located. 5. Sale of shares in other cases: this may be subject to taxation in both states, although the source state has limited taxation rights (10% or 15%). 6. Other capital gains: these may be subject to taxation in both states.

Independent personal services (article 14). They may be subject to taxation in both states, but the source state has a limited taxation right of 10%. However, if the services are developed from a fixed base (which would be equivalent to a permanent establishment) the source state may tax this income without the taxation limit or ceiling established in the double taxation convention.

Dependent personal services (article 15). When a resident does a job in the other state, both may tax the corresponding income. However, the exclusive right of the state of residence is established in certain cases where there is not a sufficient link between the job in question and the state where it is done.

Directors' fees and shareholdings (article 16). They may be subject to taxation in both states.

Artists and sportspeople (article 17). They may be subject to taxation in both states and there are no taxation limits in the source state, unlike the situation with interest, dividends or royalties.

Pensions, retirement, annuities and maintenance (article 18). Subject to tax exclusively in the recipient's state of residence. This means that the source state has no right to tax this income.

Government service (article 19). Exclusive subjection to tax in the state where the services leading to the payment of public remuneration are provided is established as a general rule. However, exclusive subjection to tax in the recipient's state of residence is established when certain requirements relating to nationality and the place where the services are provided are met.

Teachers and students (article 20). Exclusively subject to taxation in the state of residence if the stay in the other state does not exceed a year or if the remuneration paid comes from sources outside the state where the stay is made.

Other income (article 21). Both states may tax it, if it considered to originate in one or other contracting state. In all other cases, the general rule of exclusive subjection to tax in the state of residence is followed.

2.

a) To determine the calculation of remaining (183 + 1), sporadic absences must also be considered. If we consider the period of time the tennis player has been abroad (nine months) as a sporadic absence, he would therefore be resident in Spain for tax purposes. However, if the tennis player were to provide a certificate of residence for tax purposes in another country, he would not be considered to be resident in Spain, as it would not be appropriate to include sporadic absences in the calculation of stay. The 183-day rule would therefore not be complied with.

b) The organisation will not be resident in Spain for tax purposes despite the fact that it has been incorporated in accordance with Spanish law and this is precisely one of the criteria established in domestic law to determine the residence of organisations. As, under the application of domestic law, the organisation would be resident in both states, the regulation used in the double taxation convention should be applied to resolve the dispute, giving preference to the effective head office criterion.

c) Gibraltar is considered by Spain to be a tax haven (article 1 of Royal Decree 1080/1991). However, Mr. Gómez is not a Spanish national, so fiscal quarantine cannot be applied to him. From the point when he acquired residence in Gibraltar for tax purposes, he will no longer have to present his personal income tax return in Spain, as he will not be resident in this country.

However, if Mr. Gómez had Spanish nationality, although the change of residence may be exclusively for professional reasons, he would have to continue paying tax in Spain during the financial year when the change occurs and the four subsequent years. This is despite the fact that the change of residence has not been made to achieve lower taxation, is not a simulation, and even though it was proved with a certificate of residence for tax purposes from the authorities of the other state where he has effectively acquired new residence.

d) Belize is not a tax haven, but it may be considered a territory with no taxation (first additional provision of the Tax Fraud Prevention Measures Act 36/2006, of 29 November). In such a case, as the company's principal assets are in Spain there is the possibility that the Spanish administration may consider that the organisation is resident for tax purposes in this country, unless the organisation shows that the effective head office of its business takes place in Belize and that the incorporation and operation of the organisation correspond to valid economic causes and substantive business reasons other than the simple management of securities and other assets (art. 8 *in fine* Corporation Tax Act). The organisation can only destroy this assumption of residence by proving that such reasons exist.

Self-evaluation

1. b

2. c

3. b

4. c

5. c

6. a

7. b

8. a

9. c

10. c