The international tax role - Spanish ETVE

Carlos Martinez Santiago is a Senior Associate at Raposo Bernardo, Madrid office

International tax is a key factor for multinational companies in choosing where to place their activities. It is a passionate item as it is complex. Tax planning is a must have for investors who want to develop sustainable projects.

One of the countries in which it is becoming increasingly attractive for foreign investor to have a holding company is Spain. It is well known that the ETVE regime offers a wider range of vantage points compared with other jurisdictions in Europe. Essentially it is not different from any other company which takes part in economic or industrial activity in Spain and which amongst other assets, has ownership of foreign companies' share capital.

By virtue of the Spanish Double Taxation Treaty Network, which is currently being implemented in an increasing number of countries, the ETVE regime is currently regarded as a highly interesting channel for capital investments within those countries. Further to this the regime also offers an efficient channel for investors who are non-Spanish residents.

Spanish corporate tax
The average Spanish company faces a 30% taxation charge on their total income regardless of whether it is a limited liability company or a corporation with further representative investment vehicles. However there are specific lower tax rates which are applicable under certain circumstances. Medium to small sized companies can be taxed a 25% rate on €300,000 of its total benefits.

Withholding tax
A Spanish holding company, regardless of whether or not it is an ETVE regime, has to analyse the location of its subsidiaries. This enables one to ascertain whether or not the withholding of taxation will present problems in our ETVE tax plans regarding incoming dividends. If the subsidiary is a tax resident in:

- An EU member state: then any dividends remitted by the EU subsidiary to the Spanish holding company are free to withhold taxes
- A country with a Double Taxation Treaty signed with Spain: would result in a significant reduction or elimination of withholding tax rates on dividends remitted to Spain from the foreign subsidiary. Spain currently has 74 such treaties in its network.
- A tax haven or in other countries without an analogous corporate tax (similar to Spanish corporate tax rates). No withholding exemption or reduction is applicable; furthermore Spanish ordinary regimes or the ETVE regime cannot be applicable to any part of the ETVE income derived from dividends which originate from tax havens.
- Other jurisdictions: No withholding exemption or reduction is applicable, however Spanish ordinary regimes and the ETVE regime can be applicable to dividends which arise from these countries.

Therefore we must take into account which of the afore-mentioned situations will apply to withholding tax on incoming dividends.

Spanish taxation of incoming dividends
Under corporate tax law and according to the general regime, in order to avoid double international taxation of dividends (applicable also to ETVE regimes), it is necessary for us to evaluate the relevancy of the activity carried out by the foreign subsidiary. These activity’s must consist of some actual business practices existing outside of Spanish jurisdiction, namely, manufacturing, bulk trading, rendering of services, financial and assurance services, copyrights, exploitation of patents, trademarks, including technical assistance. All those activities must exist under a structured organization of human and material resources with effects in a foreign market. Expressly, the activity cannot consist of:

- Income or gains which derive from ownership of immovable goods which do not belong to an actual business activity (ie, leases or house sales)
- Dividends, interests, gains or other type of income which derive from financial assets such as stocks, bonds, bank deposits or loans, etc, unless those financial assets which are related to an actual business activity, which means, the existence of a non-resident company with a structured organization of human and material resources whose 85% (the minimal percentage) income derives from actual business activities.
- Activities such as credit, financial, insurance or general render of services not related with an export activity, under the assumption that the costs for those activities are deemed as a deductible expense for a resident in Spain which is somehow linked to the non-resident according to tax laws (for example in a Spanish parent – foreign subsidiary relationship). However, those services can be accepted in case a non-resident carries out the major part of those specific activities with third independent parties; furthermore, when it comes to credit and financial services, such services can also be accepted in the regime to avoid double international taxation on dividends in case that more than 85% of the income of the non-resident lender is derived from actual business activity.

If one of these activities is able to meet the mentioned requirements, it would be commonly known as an “active” business activity. Conversely if the activity fails to meet the requirements then it would be considered a “passive” business activity. Notwithstanding the reasonably discriminatory treatment of tax havens, Spanish corporate taxation will not charge any incoming dividends received from the foreign subsidiary of a Spanish holding, provided that the subsidiary qualifies as an "active" business activity and furthermore the holding company has owned directly or indirectly a minimum of 5% of the share capital of the foreign subsidiary within a twelve month period.

Spanish corporate tax will not charge any capital gains which originate from the sale of shares that a Spanish holding company owned in the share capital of foreign subsidiaries under the same two provisions. Regardless of whether the holding company is a true ETVE or not, all those incomes are not charged. However the first difference between and ordinary regime and an ETVE can be presented as follows: under ETVE provisions the ETVE holding must directly or indirectly own a lower than 85% of the share capital of the foreign subsidiary or either own a lower percentage of the share capital whose acquisition cost exceeds that of six million euros.

Spanish taxation on outbound dividends
According to non-residents income tax law, ordinary Spanish regimes charges on outbound dividends at 19%; however the same law exempts all dividends that a holding remits to its EU parent which holds a minimum of 5% of its share capital within a minimum period of twelve months. Moreover through the applicable double taxation treaty a non-EU parent is entitled to a reduction or even elimination of the Spanish 19% tax imposition charged on its outbound dividends.

However, under ETVE provision, regardless of the tax residence status
of the EU parent, no Spanish withholding tax will be applicable on the dividends that the ETVE remits to its foreign shareholder. Please note that this is only applicable if the recipient shareholder is not resident in Spain or a tax haven. In order to further fully understand this situation, we must take into account that this privilege is only applicable to dividends which are distributed out of exempt dividends or exempt capital gains obtained by the ETVE from its foreign subsidiaries. Therefore this privilege will never be applicable to outbound dividends which arise from ordinary activities (i.e. industrial activities) that the ETVE might carry out in Spain. Moreover there exists a thin capitalisation rule for the Spanish holding company (regardless of its ETVE condition or not) and its lender or is other linked/associated companies. A 3:1 financing/equity ratio must not be exceeded so as to prevent interest being deemed deductible expenses according to Spanish corporate tax law. This provision however is not applicable on loans granted by linked/associated companies resident in an EU member state.

**Spanish taxation on capital gains**

According to non-residents income tax law, ordinary Spanish regimes charge capital gains a 19% tax rate. However under the same ordinary regimes, Spanish non-residents income tax law declares non-chargeable capital gains which arise from the sale of participation in share capital of Spanish company, under the following circumstances:

- When the main assets of the Spanish company were not immovable ones, or,
- When the participation in the share capital of the Spanish company exceeded 25% within the 12 previous months

Moreover, when it comes to a non-EU parent, the applicable double taxation treaty may eliminate or reduce the Spanish 19% tax rate to be charged on those capital gains. In other circumstances, Spanish taxation would be applicable. If so: what happens if the foreign resident shareholder sells its participatory share capital of a Spanish company that exists as an ETVE?

Spanish ETVE regime states that the following types of income will not be charged in Spain:

1. The part of the capital gain which corresponds to non-distributed profits of the holding company, providing that those profits come from exempt dividends or capital gains already obtained by the holding company from its subsidiaries
2. The part of the capital gain corresponding to hypothetical capital gains which would have been declared exempt in the event that the holding company (both ETVE and an ordinary company) had sold its participation of share capital of its subsidiaries

The remaining part of the capital gain will be charged in accordance with the non-residents income tax regime: 19% of the resulting difference between the sale value and its theoretic value, unless applicable double taxation treaty settles otherwise.

If the subsidiaries do not meet all the requirements for them to enjoy the benefits of an ETVE regime (i.e. non foreign residents, residents in tax haven, not actual business activity, etc.) dividends or capital gains will not be deemed exempt, however, a tax credit may apply under some circumstances. This tax credit will reach to the lowest of these two concepts: an amount equal to the actual taxes paid in the foreign jurisdiction or up to an amount equal to the tax which would have been paid in Spain for that income.

**Requirements and incompatibilities for the ETVE:**

- The ETVE statutory corporate purpose must include the management and control of participation’s of non-resident subsidiaries.
- The shares of the ETVE must be nominative.
- A simple application for the ETVE regime must be filed to the Spanish tax authorities.
- There must be a person in charge in order to structure the shareholder’s duties (voting rights, attending meetings, special fees for this performance, agreements in writing, description in the annual account memorandum, etc.), a suitable candidate would be one of the directors with enough material resources at their disposal to meet those obligations.
- The ETVE cannot be a company whose main activity is the simple management of a movable or immovable asset, such as holding companies held by a family group with no actual business activity.

**Conclusion**

The combination of Spain’s double tax treaty network and its ETVE regime means that there are currently a number of tax efficient routes for dividends through Spain. The broad tax treaty network (especially with Latin America countries) and the European features of the ETVE make this regime a tax-efficient channel for investments by non-EU companies provided they are not resident in a tax haven.

Furthermore, Spain has signed multilateral and bilateral investment treaties, especially with many Latin America countries, whose purpose is the protection of Spanish investments in those countries by settling that every Spanish investment will be treated in the same manner as domestic investments.

The ETVE mechanism in Spain is a good example of what can be done by countries to attract and retain foreign investment, a critical antidote against lower investment in economic downturns.

For further information contact:

RAPOSO BERNARDO

cmsantiago@raposobernardo.com
www.raposobernardo.com

---

1. ETVE is the acronym for “Entidad de Tenencia de Valores Extranjeros” or Foreign Shares Holding Company