

NEWS 2.004

As usually, the Spanish Fiscal, Administrative and Social Measures Act for the State Budget for the year 2004, ("*Ley de medidas fiscales, administrativas y del orden social*"), enacted on 23rd December 2003, has introduced amendments affecting several provisions on the Spanish tax system.

Most relevant changes operated in the field of the international tax planning as consequence of the said Act are:

I.- PERSONAL INCOME TAX (*Impuesto sobre la Renta de las Personas Físicas, I.R.P.F.*)

I.I.- Residence in Spain for tax purposes

As a consequence of the introduction of a new section in article 9 of the Personal Income Tax Act, individuals acquiring Spanish residence for tax purposes, as a result of a moving to Spain, may choose, from 2004 on, between being liable to Personal Income Tax or to Income Tax on Non-residents in the year of their moving and the five subsequent years. This means that the individual is taxable as a non-resident although he stays for more than 183 days in a calendar year in Spain.

This measure, already introduced by other European countries, aims to encourage foreign company executives to move their residence to Spain.

According to the preceding legislation, a foreign individual acquiring Spanish residence for tax purposes was liable to Personal Income Tax (whose maximum rate reaches 45%) in respect of their worldwide income. Income Tax on Non-residents sole rate is 25% and only on Spanish-source income, although it is not possible to benefit from any deduction.

It is necessary to comply with some requirements in order to be allowed to opt between both taxes: the individual must not have been resident in Spain for the preceding ten years; the moving needs to be consequence of an employment contract, and the work must be effectively executed in Spain. Moreover, the work needs to be carried out for an entity resident in Spain or for a permanent establishment of a foreign company in Spain. Finally, employment income obtained cannot be exempt on the Income Tax on Non-residents.

Tax payers choosing being subject to Income Tax on Non-residents, will be also liable to Net Wealth Tax in respect of their assets in Spain.

I.II.- Controlled foreign company

From 1st January 2004 on, the Spanish CFC regime does not apply if the foreign related subsidiary is resident within the European Union territory, except if the country of residence is deemed to be as tax haven.

Under the “international fiscal transparency” regime, which is the equivalent of a CFC regime, a Spanish-resident owning, directly or together with any related individual or company, 50% or more of the capital, equity, results or voting rights of a foreign company may be subject to personal income tax on certain types of passive income of the non-resident entity.

These non-resident entities must be located in countries where the corporate income tax paid by the CFC in connection with the attributed positive income is less than 75% of that which would have been payable under Spanish corporate income tax rules.

The passive income to which the regime applies is that from immovable property or rights thereon not used in business activities, from financial assets, from loans between related parties and capital gains from the disposal of such immovable property or assets and obtained by the CFC.

I.III.- European Council Directive on taxation of savings income in the form of interest payments.

From 1st January on, Spanish Personal Income Tax act implements EC Directive on taxation of savings income in the form of interest payments, so that the amounts withheld by those countries that, provisionally, do not put into effect the exchange of information clauses contained in the Directive (Belgium, Austria, Luxembourg) will be considered by Spain as an advance payment of Personal Income Tax.

II.- CORPORATE INCOME TAX (*Impuesto sobre Sociedades, I.S.*)

II.I.- Thin capitalization (Art. 20 Corporate Income Tax Act, CITA)

As a consequence of the decision of the European Court of Justice (ECJ) on 12th December 2002 (*Lankhorst-Hohorst*),¹ Spanish legislators have introduced a new paragraph to Art. 20 of the LIS on thin capitalization that excludes EU companies from the application of the thin capitalization rules. The Spanish thin capitalization rules provide that: if the average total loan made to a company resident in Spain by a non-resident related company during the tax year is more than three times the amount of the

¹ ECJ, 12 December 2002, Case C-324/00, *Lankhorst-Hohorst*, held that the German thin capitalization regulation infringed the right of establishment in Art. 43 EC.

borrower's average net worth in that year, the amount of interest attributable to the excess will be recharacterized as a dividend for tax purposes. As a result, this interest cannot be treated as a deductible expense and is subject to dividend withholding tax.

The new paragraph introduced by the Fiscal, Administrative and Social Measures Act now provides that the thin capitalization rules will not apply to loans received from related companies resident in the European Union, as of tax years starting 1st January 2004.

II.II.- Exemption on dividends and foreign source income (art. 20 bis CITA)

One of the requirements of the international participation exemption regime included in the Spanish Corporate Income Tax Act (CITA) states that the foreign subsidiary must be subject to a tax which is similar to the Spanish Corporate Income Tax.

The fulfilment of this requirement is presumed if the foreign subsidiary may apply a Double Tax Treaty concluded with Spain, supposed the DDT contains a clause on exchange of information.

Previously, the Spanish tax authorities could decide the no application of this presumption when they could prove that the foreign tax was not similar to the Spanish Corporate Income Tax. From the 1st January 2004 on, the tax authorities may not use this right of evidence any more, which means that the requirement is always presumed fulfilled when a DDT can be applied.

II.III.- Deductions for avoidance of double taxation on dividends and domestic source income (Art. 28 CITA)

Resident companies in Spain, which obtain dividends and certain other income (such as income derived from the liquidation of the subsidiary) distributed by a subsidiary resident in Spain, may deduct 100% of the total tax liability corresponding to the taxable base derived from the above mentioned type of income obtained.

As condition for enjoying this benefit a participation of at least 5% shall be held during one year previous to the date the income becomes due. From 1st January 2004 on, it is possible to meet the requirement of the minimum holding period also after the date the income becomes due.

II.IV.- New tax regime on venture capital companies and funds (Art. 69 CITA)

Venture capital entities are subject to be taxed under the CITA, although they may benefit from a special tax regime on the dividends and capital gains obtained in relation to their participations in other enterprises.

The Fiscal, Administrative and Social Measures Act has introduced several modifications which make investments in venture capital entities even more attractive.

Venture capital entities are exempt from taxation on 99% of the income derived from the transfer of participations in enterprises, other than financial companies, which are not listed on the Stock Exchange when the participations are acquired.

In case the subsidiary gets listed on the Stock Exchange after the acquisition of the participation, the above mentioned exemption only applies if the concerned participation gets transferred within a period of two years from the date the subsidiary gets listed on the Stock Exchange.

From 1st January 2004 on, the period for transferring the participation gets extended from two to three years.

The exemption is also conditioned to the fact that the transfer of the participation must be executed between the second and the fifteenth year of maintenance of the participation. Exceptionally, this period may be extended to the twentieth year of maintenance.

Venture Capital entities may also benefit from the total exemption of dividends obtained from resident (Art. 28.2.CITA) and -from now on- non resident subsidiaries (Art. 20bis CITA), without being subject to the one year-holding period stated in these regimes. As mentioned above, the subsidiary must be a non financial entity and may not be listed on the Stock Exchange at the moment of the acquisition of the participation.

II.V.- CFC-Rule

As already exposed in a previous chapter, from 1st January 2004 on the Spanish CFC-rule does not apply if the foreign related subsidiary is resident within the European Union, except the country of residence is qualified by Spain as tax haven.

II.VI.- Taxation of contributions in kind as to the special regime on mergers, spin-off, contributions of actives and exchange of quotes (Chapter VIII Part VIII CITA)

The special regime contained in Chapter VIII part VIII CITA has been amended conceding an exemption in the Spanish Transfer Tax (*Impuesto sobre Transmisiones Patrimoniales*) to contributions in kind made by companies resident in Spain or by Spanish permanent establishments of non resident entities, provided the conditions established in Art. 108 CITA are met.

This exemption contained in the Transfer Tax Act and in the Eight Additional Disposition of the CITA has been abolished in the beginning of the tax year 2003 and has re-entered into force on 1st January 2004.

III.- INCOME TAX ON NON-RESIDENTS (*Impuesto sobre la Renta de No Residentes, IRNR*)

III.I.- Taxation on royalties

Income Tax on Non-Residents Act extends the concept of royalties, implementing EC Directive 2003/49 of 3rd June 2003, on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, so that payments for the use of, or the right to use, industrial, commercial or scientific equipment will be regarded as royalties.

From January 2005 on, as an implementation of the mentioned EC Directive, the withholding rate on Spanish-source royalties paid by a company resident for tax purposes in Spain or by a permanent establishment in Spain of a company resident in an EU Member State, to an associated company resident within the European Union territory, is reduced to 10% on the gross amount paid.

According to the provisions of the Directive implemented by Spain, in order to benefit from such rate, the beneficial owner of the royalties must comply with some requirements.

IV.- CRIMINAL LAW

Although this amendment was introduced in 2003, through “Ley Organica” 15/2003, 25th November, it is important to underline, due to its importance that the minimum amount to consider a tax evasion as a penal fault has been increased to 120.000,00 Euro.