

# The Spanish Holding Company Regime

by David Mülchi & Asociados\*

*(This note will take a look at the practical application of the Spanish Holding Company Regime, being an interesting vehicle to those international groups that intend to centralize investments in the companies participating in the group).*

The Spanish Corporate Tax Law 43/1995 introduced a new form of international holding company, the ETVE (the Spanish short-name for Entities Holding Foreign Securities). The ETVE tax regime has been improved by new legislative modifications of the former regulation in order to make it more attractive for international groups.

The ETVE is defined as an entity which will have within its corporate object, the supervision and management of securities issued by companies non-resident in Spain. These securities must represent a participation in the foreign company of, at least, 5 per cent of its share capital or have a purchase value higher than Euro 6 millions.

The Spanish ETVE will be exempt from the Spanish corporate tax on the foreign-source benefits, including the dividends it receives and the capital gains it realizes on the sale of foreign participations in the terms described below.

Another important feature is that an ETVE can distribute, to its non Spanish resident shareholders and without a permanent establishment in Spain, the profits that result from the receipt of foreign exempt income, as described below, free of any Spanish withholding tax (except if they reside in a country included in the Spanish black list of tax havens).

## **Tax Treatment of Foreign Source Dividends and Capital Gains**

Benefits, including dividends, received and capital gains realized by an ETVE will be exempt from the Spanish corporation tax provided the following requirements are met:

### *1. Dividends:*

(a) The participation of an ETVE in the foreign company paying the dividends must be of, at least, 5 per cent of its share capital or have an initial purchase value higher than Euro 6 millions.

(b) The Spanish ETVE must be properly organized and have the financial and human resources to manage the foreign participation, although this requirement is not interpreted strictly by the Tax Administration and an Administrator or Board of Directors will be enough to fulfil with this.

(c) The participation must be held continuously at least for the entire year preceding the date on which the dividends can be claimed by the ETVE, although the one year holding period can

also be completed after reception of the dividends. Periods during which the same participation was held by other companies of the same group as the ETVE are also taken into account.

(d) The share capital of the ETVE cannot be divided into bearer shares, only registered shares are permitted.

(e) The foreign companies, in which the participation is held, must be subject in the country where they are resident and during the fiscal period, in which the benefits have been obtained, to a tax similar to the Spanish Corporate Income Tax. This requirement is presumed (the presumption can be rebutted) when the company is resident in a country with a Double Tax Convention in force with Spain, provided such a Double Tax Convention has an exchange of information provision.

(f) The foreign company must not be a resident of a country or territory classified as a tax haven under Spanish internal legislation. If it is resident in a tax haven, then dividends (and capital gains) derived from the participation will be taxed in Spain at the standard rate of the corporate income tax, i.e. 35 per cent.

(g) At least 85 per cent of the foreign company's income, out of which dividends are paid to the ETVE, must have arisen from (1) active business activities (as defined by the Spanish law, which includes among them credit and financial transactions, and excludes income attributed to the Spanish company under the Spanish CFC rules) undertaken by the foreign company outside Spain and/or (2) participation in benefits or capital gains from foreign companies participated by the ETVE subsidiary, provided the ETVE has, at least, 5 per 100 of their equity (or, subsidiarily, the participation has a value of Euro 6 million) and the second-tier subsidiaries comply with the active business activity test.

## 2. *Capital Gains.*

Capital gains realized from the disposal of a participation in a foreign company (including those arising upon separation of the shareholder or dissolution of the foreign company) are exempt from Corporate Tax in the hands of the ETVE, provided the above described conditions applicable to dividends are duly satisfied.

There are certain limitations, however, for the following cases:

(1) the market value of the participations of the non-resident subsidiary in Spanish companies or the assets of such a company located in Spain are higher than 15 per cent of its total assets: the exemption is limited to the part of the income corresponding to the net increase of non distributed profits generated by the participated entity during the time the participation is held;

(2) the ETVE has written down the transferred participation and such a correction is tax deductible: the exemption is limited to the excess of gain obtained upon the transmission over the amount of the correction;

(3) the participation in the foreign subsidiary has been acquired from a Spanish company belonging to the same group as the ETVE: the negative income obtained upon transmission of the participation will be reduced on the amount of positive income obtained in the transmission of the same participation upon which the exemption is applied; the positive income obtained in the transmission of the participation held in the non-resident entity will be taxed until the amount of negative income obtained in precedent transmissions included in the Corporate Tax base.

(4) Setting up of the ETVE by a merger, spin-off, exchange of shares or asset contribution benefiting from the Merger Directive and the Spanish legislation implementing such a Directive and transmission of the participation after one of the indicated transactions: the capital gain exemption is applicable only to the positive difference between the sale value of the participation

in the non-resident company and the market value of the participation when it was acquired by the ETVE (the latter is a proposed modification not yet in force, which may be subject to change in the legislative procedure before approval)

### *3. Common Rules Applicable to Benefits and Capital Gains Obtained by the ETVE*

The exemption for benefits, including dividends and capital gains will not be applicable in the following cases:

(1) Foreign source income obtained through a temporary association of companies (in Spanish *Unión Temporal de Empresas*) and obtained through either Spanish or European economic interest association (in Spanish *Agrupaciones de Interés Económico*).

(2) Dividends and capital gains in relation to which the ETVE decided to apply the credit method for the elimination of double taxation set out in the internal legislation.

(3) In connection with foreign subsidiaries which decided to carry out their activities abroad for the purpose of benefiting from the ETVE regime. This is presumed to occur when the activity carried out by the foreign subsidiary was previously exerted by another company from the same group as the subsidiary, except when a valid commercial reason for such a change is proved.

### *4. Other Income.*

Income realized by an ETVE other than dividends and capital gains benefiting from the exemption will be subject to the Spanish corporate tax at the standard rate of 35 per cent. Under the former regulation, the ETVE was bound to have a primary corporate object (the managing of foreign participations), however, the current legislation in force seems to make that requirement more flexible so that the ETVE does not have to have such management as its main corporate object.

It is important to note that Spain permits the deduction of interest paid to Spanish or foreign residents (some limitations may apply in the case of tax havens) and the carry-forward of losses. The ETVE may benefit from those advantages for its income subject to tax in Spain.

### *5. Thin Capitalization.*

If an ETVE borrows funds from a related foreign company to finance the acquisition of shares in foreign subsidiaries, a debt: equity ratio of 3:1 is required. However, in situations where the foreign shareholders can claim the benefit of a Double Tax Treaty, the Spanish tax authorities may agree to increase the ratio.

## **Distribution of Profits by an ETVE to its Shareholders and Transmission of the Participation in the ETVE**

Benefits, including dividends, remitted by the Spanish holding company to its non-resident shareholders without a permanent establishment in Spain are not subject, in accordance with Spanish domestic law, to withholding tax in Spain, provided they are paid out of exempt foreign-source dividends and capital gains.

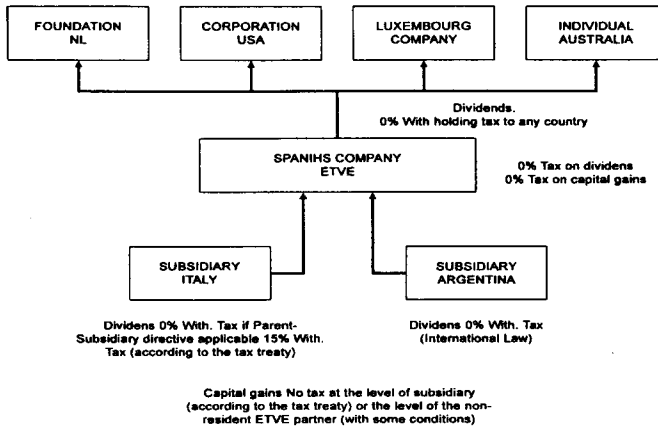
In the event of the distribution by an ETVE of dividends, which are paid out of profits that have been ordinarily taxed in Spain, the 15 per cent Spanish withholding tax will be levied on such distributions, unless a lower rate applies under a tax treaty between Spain and the country of residence of the shareholder or the non-resident company can benefit from the Parent-Subsidiary Directive (0 per cent withholding tax in such a case).

Transmission of the ETVE participation by non-resident shareholders without a permanent

establishment in Spain will not give rise to a capital gain taxable in Spain for the part of it corresponding to reserves formed out of income exempt from tax in the hands of the ETVE or with differences in value of the ETVE's participation in foreign entities that benefit from the ETVE tax regime.

If a shareholder of the ETVE is resident in a territory that is, in accordance with Spanish regulations, a tax haven, a withholding tax of 15 per cent will be levied on benefits remitted to that shareholder, and the benefits for the transmission of the participation in the ETVE will not apply.

### The Following Diagram Shows the Advantages of the ETVE:



### Grant of the ETVE Status

Unlike the precedent legislation, now the ETVE status will be applicable upon communication to the Spanish Tax Administration that the taxpayer wishes to benefit from such a tax regime. The ETVE special treatment will be effective for the tax periods ending after such a communication (although it is conditioned by the fulfilment of the substantive requirements mentioned above).

### Advantages of the New Spanish Holding Company Regime (ETVE)

The ETVE tax regime is fully comparable with the participation exemption or holding company status offered by other jurisdictions, or can be even more advantageous in some cases. Therefore, the ETVE should be taken into account by those considering transnational investments in foreign subsidiaries as an excellent tax planning vehicle. It is important to stress in this regard, that the Spanish ETVE has not been marked, unlike e.g. Danish or Dutch holding companies, as a harmful tax measure by the Group in Charge of Implementing the European Union Code of Conduct on Business Taxation.

The Spanish ETVE is a resident company for the purpose of Double Tax Treaties signed by Spain, which basically means that it can benefit from the provisions of such norms (some limitations may apply if the Double Tax Treaty contains a limitation on benefits provision, which, although not usual in Spanish Double Tax Treaties, may be found in some of them: e.g. Portugal, Ireland, US).

Spain has an increasingly important Double Tax Treaty network featuring about forty Double

Tax Conventions with almost all European countries, some of them with Latin American countries such as e.g. Argentina, Brazil, Bolivia, Ecuador, or Asian States such as China, Korea, Philippines, India, Indonesia or Thailand. The Spanish Treaty Network is expanding rapidly and is expected to grow in the coming years.

Additionally, the Spanish ETVE may take advantage of the Parent-Subsidiary Directive: 0 per cent withholding tax for dividends received from subsidiaries resident in other European Union countries (if the conditions for the application of such a norm are complied with).

Moreover, the ETVE is exempt from Stamp Duty (1 per cent) payable on the issue of shares if the subscription price for the ETVE shares is paid in kind, for example, when the shareholders of an ETVE exchange assets (e.g. shares in foreign companies) they own for shares of the ETVE (provided the shares in the non-resident companies comply with the requirements, mentioned above, for the benefit or capital gains exemption in the hands of the ETVE to be applied).

### **Highlights of the Spanish Law Corporations**

- For purposes of international holding companies, the most common corporate entities available are the private limited liability company (Sociedad Limitada, SL) and the company limited by shares (Sociedad Anónima, SA).

- SL or SA are both incorporated by one or more parties signing a Memorandum of Association.

- The minimum share capital required for a SA is EUR 60,101.21 and for a SL is EUR 3,005.06.

- Bearer shares are permitted. In this case the share capital of the SA must be fully paid up in cash or in kind before the incorporation of the company.

- The Board of Directors or the sole director of a SL or a SA may consist of one or more legal entities or individuals.

- No auditing is required, provided the assets of the SA or SL are less than EUR 2,373,997.81 and the gross income is less than EUR 4,747,995.62 or the number of the company's employees does not exceed 50.

Foreign companies can transfer their effective management to Spain, thus attaining the status of Spanish companies for legal and tax purposes. There are also provisions in the Spanish legislation allowing the transfer of the Statutory seat of a Spanish company, provided there is reciprocity of treatment in the company law of the foreign country in question.

### **Procedure for the Incorporation of a Spanish Company**

We need from the clients information containing details of the company to be incorporated, such as the corporate name, the amount of share capital, the particulars of the shareholder or shareholders, the intended business activities and the proposed directors. David Mülchi & Asociados may provide directors for the management and administration of the company, if required.

Once the above information is received, the procedure for the incorporation and establishment of a Spanish company is as follows:

**Name:** The approval of the commercial Registry will be sought for the name of the company. A maximum of three names may be submitted for each application.

**Bank account – NIF:** The corporate bank account will be opened, the application for the NIF (fiscal number identification) will be submitted and the funds required for the payment of the company's share capital will have to be transferred to the corporate bank account. The bank holding the corporate account will issue a "share capital blocking certificate" that will be attached to the Articles of Incorporation.

**Power of Attorney:** The proposed shareholder of the Spanish company will be requested to issue a special power of attorney authorizing David Mülchi & Asociados to incorporate the company.

**Public Notary:** Once all the required documents are available (application for the registration of the name, the Memorandum of Association, the blocking certificate, the power of attorney) a Public Notary will prepare the Articles of Incorporation, the draft of which the client will receive in advance for his approval.

**Commercial Registry:** The Articles of Incorporation will be registered with the Commercial Registry. Normally, it takes three weeks for the registration to be effected. However, the company can commence operations as soon as the Public Notary issues the Articles of Incorporation.

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*David Mülchi & Asociados is an international legal and tax advisory firm whose aim is to act as an authentic "boutique" for its resident as well as non-resident clients in Spain. Our services are mainly provided to all legal and tax professionals, companies and entrepreneurs, engaged in crossborder business and investments. In particular, we specialize in all matters relating to investment, trade, company incorporation (Spanish Holding Companies, companies in the Canarian Free Trade Zone...) and international conflicts on civil, commercial and tax law. Our firm also has an extensive network of external correspondents and advisors selectively chosen and due to our specialization approach, we are able to offer an always personalized advice.*

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