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1. Types of Business Entities Commonly Used, Their Residence and Their Basic Tax Treatment

1.1 Corporate Structures and Tax Treatment

Although different kinds of corporate structures are recognised by Spanish legislation, the most widespread in Spain are those that limit the shareholders' liability for the corporate debts to capital contributed – ie, Limited Liability Companies ("*Sociedad de Responsabilidad Limitada*" – SRL) and Public Limited Companies ("*Sociedad Anónima*" – SA), whose main features are as follows.

Capital: both SAs and SRLs require a minimum capital. For an SA, the minimum capital is EUR60,000, which will be divided into shares, and for an SRL the minimum is EUR3,000, which will be divided into stakes. In both structures the capital must be fully subscribed at the time of formation. Nevertheless, in the case of an SA at least 25% of the par value of the shares must be paid in, whilst in the case of an SRL it must be fully paid in at the time of formation.

Shareholders: neither an SA nor an SRL requires a minimum number of shareholders, provided that there is at least one.

In the Spanish legislative system, SRLs – which are far and away those most preferred by traders – have traditionally been configured as simplified and flexible SAs.

Other kinds of companies, although not very commonly used, are the Partnership Limited by Shares ("*Sociedad Comanditaria por Acciones*"), the Simple Partnership ("*Sociedad Comanditaria Simple*") and the General Partnership ("*Sociedad Colectiva*"). The main difference between these and the companies mentioned above is that (all or certain) partners are personally liable for the debts of the partnership. Only capital partners of a Partnership Limited by Shares and a Simple Partnership limit their liability to the capital contributed.

In general, all the Spanish corporate structures are taxed separately under Corporate Income Tax (CIT).

1.2 Transparent Entities

At present, the tax transparency regime remains in force only for non-resident entities held by Spanish residents (see **6.5 Taxation of Income of Non-Local Subsidiaries under CFC-Type Rules**).

The Spanish tax legislation provides for two special regimes, which, although different from tax transparency, result in a similar tax treatment:

- the income attribution regime; and
- the special regime applicable to Economic Interest Groupings (EIG – "*Agrupaciones de Interés Económico*") and Temporary Business Associations (TBA – "*Uniones Temporales de Empresas*").

The income attribution regime is applicable to certain structures, such as "*sociedades civiles*" that are not subject to CIT, unsettled estates ("*herencias yacentes*"), co-ownership and other bodies without legal personality, as well as any foreign entities whose legal nature is identical or similar to those created according to the Spanish legislation.

In terms of taxation, the "income attribution regime" is a "flow-through" regime under which the taxable income obtained by the entities is allocated directly to their partners/members; this also includes the deductions, withholding taxes, instalment payments, etc. However, if all the partners/members are corporate income taxpayers, the taxable income will be calculated according to CIT rules.

Any entity incorporated abroad that is of an identical or analogous legal nature to the Spanish income attribution entities (eg, certain partnerships) may be deemed to be carrying out an economic activity in Spain, or not. Entities carrying out an economic activity in Spain, such as professional firms, would be deemed to have a permanent establishment (PE) in Spain, and would be taxed on the income that was attributable to non-resident partners/members. Outside these exceptions, the income attribution entity will be taxed only on the income at the Spanish source.

Together with the "income attribution regime", there is a special regime applicable to EIGs and TBAs, under which the taxable base calculated at the level of the EIG/TBA is subsequently allocated to their Spanish resident partners and, therefore, not subject to taxation at the level of the EIG/TBA. The part of the taxable base which is attributable to non-resident partners will be subject to taxation at the level of the EIG/TBA.

1.3 Determining Residence

Incorporated Businesses

An incorporated business will be considered to be resident in Spanish territory if one of the following requirements is fulfilled:

- it has been incorporated under Spanish law;
- it has its registered office in Spanish territory; or
- it has its place of effective management in Spanish territory.

For this purpose, it is understood that an entity has its place of effective management in Spanish territory when its activities are managed and controlled from it.

Nonetheless, the Spanish tax authorities may presume that an entity is tax resident in Spain if it is located in a tax haven or in a territory with low or zero taxation when its main assets are directly or indirectly located in Spain, or consist of rights to be exercised in Spain, or if their main business activity is carried out in Spain.

Transparent Entities

The rules shown above are also applicable to determine the residence for tax purposes of EIGs and TBAs.

The relevant tax residence in these cases will be the residence belonging to their partners/members.

1.4 Tax Rates

Spanish incorporated businesses are liable to CIT, and will be subject to the tax rates established by the CIT Act (Spanish Act 27/2014, of 27 November).

The general 25% corporate tax rate applies to the worldwide profits and capital gains of resident companies.

Newly incorporated entities will be subject to a reduced tax rate of 15% in the first tax period in which their taxable base is positive, and the following one, provided certain requirements are met.

Non-resident companies operating in Spain through a PE are liable to Non-Resident Income Tax (NRIT), with similar terms to Spanish resident companies. In particular, the applicable tax rates are the same as those set forth in the CIT Act.

2. Key General Features of the Tax Regime Applicable to Incorporated Businesses

2.1 Calculation for Taxable Profits

Spanish entities with a separate legal status are subject to Spanish CIT on their worldwide income/capital gains.

The CIT Act establishes a general method for determining taxable income (the so-called direct assessment method), according to which the taxable profit is based upon the accounting profit or loss disclosed in the company's financial statements, corrected with certain tax adjustments that intend to respect the taxpayer's actual contribution capacity. Please note that Spanish Generally Accepted Accounting Principles (GAAP) are adapted to IFRS criteria.

Tax adjustments may be motivated by:

- allocation differences – profits and expenses may be allocated for accounting and tax purposes in a different period;
- qualification differences – expenses related to the business activity are deductible if they are properly accounted for and justified, and if the timing of recognition rules has been fulfilled; however, certain expenses are not tax deductible; or
- valuation differences – certain profits and expenses must be valued with different criteria for tax purposes.

As a general rule, an accrual criterion is applied in order to calculate taxable income.

2.2 Special Incentives for Technology Investments

The CIT Act provides for both "patent box" and R&D incentives.

Incentive Designed for Patent Box

This incentive has the objective of promoting the performance of activities which lead to the creation of technical knowledge with an industrial aim in the context of an innovative activity. It should be noted that this incentive has been designed in a restrictive way that reduces its scope of potential beneficiaries.

This incentive applies to income derived from the licensing and/or transfer of the following intangible assets: patents, utility models, supplementary protection certificates for medical products and plant protection products, legally protected drawings and models that derive from research and development and technological innovation activities, and advanced software that derives from research and development activities.

Royalties from any other source (eg, trade marks, copyright of literary, artistic or scientific work including cinematograph films, image rights, software, lease of industrial commercial or scientific equipment, as well as know-how, etc) are expressly excluded from this incentive.

As a general rule, since 1 July 2016, this reduction may be subject to certain limitations, or even eliminated. The transfer of intangible assets to related parties cannot benefit from this reduction. This new rule intends to implement the "nexus" approach contained in the OECD final report on Action 5 of the BEPS project.

The patent box incentive is not limited and is compatible with the R&D tax credit (explained below), so in certain situations both incentives may apply at the same time.

Special Treatment of R&D Expenses
The CIT Act provides for a deduction for research and development activities and technological innovation. R&D expenses and investments included in the tax credit base must relate to activities carried out in Spain or in any Member State of the European Union or the European Economic Area.

The deduction base is formed by the full amount of R&D expenses and investments in elements of tangible and intangible fixed assets (except real estate), reduced by the amount of any subsidies received to encourage such activities.

The general deduction percentage is 25% of the R&D expenses incurred in the fiscal year for this concept (42% on the excess in respect of the average amount spent in the previous two years).

An additional 17% can be applied to expenses linked to research personnel assigned exclusively to R&D activities.

The CIT Act also establishes a tax credit of 8% for investments in tangible fixed assets (except real estate) and intangible assets to be used exclusively for R&D activities.

It also provides for a deduction for technological innovation (TI) activities that further the activities for the mass production or commercial exploitation of the achieved developments. TI is defined as "the activity the result of which means a technological advantage to obtain new or substantially improved products or manufacturing processes."

The deduction percentage amounts to 12% of the total amount of expenses incurred for this concept.

In order to provide certainty in connection with the application of this incentive, certain procedures (obtaining a biding ruling from the tax administration and/or obtaining a "Reasoned Report" issued by the relevant Ministry) have been implemented, which are binding with the Ministry of Finance.

2.3 Other Special Incentives

Entities Engaged in Residential Lease Activities
There is a tax credit of 85% of the income derived from residential lease activities (residences located in Spain), provided certain requirements are fulfilled.

Dividends distributed from the income that benefitted from the aforementioned tax credit would be only 50% exempt at shareholder level.

Listed Corporations for Investment in the Real Estate Market ("SOCIMIS")
A special tax regime also applies to Spanish REITs. SOCIMIs are corporations whose main purpose is the acquisition and development of urban real estate for leasing purposes, including building refurbishment and holding shares in certain entities.

In broad terms, SOCIMIs are taxed at a 0% rate, so taxation takes place at the level of the shareholders.

However, SOCIMIs are taxed at a special rate of 19% of the amount of the dividends paid to the shareholders when those dividends are tax-exempt for the shareholder or taxed at a rate lower than 10%. Notwithstanding, no withholding tax would apply to dividends paid by a Spanish SOCIMI to another Spanish SOCIMI.

Lastly, the transfer of a non-relevant stake (less than 5% share capital) in a SOCIMI by a non-resident taxpayer would be tax-exempt.

Collective Investment Institutions (CIIs)
In general, CIIs (corporates and funds of a financial and real estate nature) are taxed at a rate of 1% of their profits. They cannot apply any tax credit, although closed-end type CIIs benefit from the tax regime explained under Venture Capital Entities, below.

Real estate CIIs may enjoy reduced tax rates, provided that their exclusive purpose is investment in the letting of urban real estate (by means of direct acquisition or promotion).

Venture Capital Entities (Corporates and Funds)
Special rules apply to venture capital entities, as follows:

- a 100% exemption is applied to the gross tax payable on dividends that are derived from companies in which they are a party if certain requirements have been fulfilled – this operates independently of the percentage of interest held and the holding period; and
- a 99% exemption is applied for any capital gains received as a consequence of the transfer of securities in non-financial and non-real estate companies that are not listed for trading. In general terms, this exemption is applicable if the transfer is made between the second and the 15th year.

Small-sized Enterprises
Small and medium-sized companies (whose turnover in the previous fiscal year is less than EUR10 million) benefit from two main incentives:

- free and accelerated depreciation if the required criteria are fulfilled; and

- tax base levelling reserve – this special rule, similar to a tax loss carry-back, enables taxpayers to reduce their tax base by up to 10%, capped at EUR1 million.

Finance Lease Agreements
Provided certain conditions are met, the tax amortisation may be accelerated by the finance lessee, by means of increasing the maximum tax depreciation coefficient by up to double (or triple for small or medium-sized enterprise).

Holding Companies of Non-resident Entities (ETVE Regime)
Dividends and capital gains obtained by ETVE from shares in non-resident companies can be exempt from taxes in order to avoid double taxation, if certain conditions noted in **6.3 Taxation on Dividends from Foreign Subsidiaries** and **6.7 Taxation on Gain on the Sale of Shares in Non-local Affiliates** are met.

Additionally, the regime sets forth a beneficial tax treatment for non-resident shareholders. Under certain conditions, dividends and capital gains obtained by non-residents may not be subject to taxation in Spain.

Investment in Production of Films, Series and Musical and Performing Arts Live Shows
These activities have specific incentives set forth in the CIT Act:

- film and series production – a tax deduction for investments in Spanish productions amounts to 20% over the first EUR1 million of the tax credit base and 18% for the remaining production costs, capped at a total amount of EUR3 million tax credit; and
- life spectacles of musical and performing arts – the tax credit rate is 20% of certain artistic, technical and promotional direct costs incurred, capped at EUR500,000.

Foundations, Associations of Public Use and Other Non-Profit Organisations that Meet Certain Conditions
This regime provides for a total exemption in relation to contributions and donations received by such entities and for income from business, provided that they are connected with its general interest purpose. Non-exempt income is taxed at a 10% rate in the case of foundations and associations of public use, and at a 25% rate in the case of other partially exempt entities.

2.4 Basic Rules on Loss Relief

The CIT Act allows the offsetting of negative tax bases without any time limitation. Income losses can be offset with capital gains, and vice versa, without limitation.

The carry-back of losses is not permitted. However, a special rule ("tax base levelling reserve"), as explained in **2.3 Other Special Incentives** under the heading "Small-sized Enterprises", may produce a similar outcome.

The amount of negative tax bases that can be offset in every tax period is limited for all taxpayers, irrespective of their size, to 70% of the tax base existing prior to deducting the capitalisation reserve. The limit is 50% for those taxpayers whose turnover in the previous 12-month period amounted to between EUR20 million and EUR60 million, and 25% for taxpayers whose annual turnover exceeded EUR60 million.

In any case, EUR1 million carry-forward tax losses can be used without any limitation.

The 70% limit would not apply in other situations, such as when the company is dissolved or liquidated, unless it is due to the tax neutrality regime applicable to restructuring transactions.

2.5 Imposed Limits on Deduction of Interest

There are limitations on the deductibility of financial expenses, which have replaced the previous thin capitalisation rule.

Limit for Intra-Group Financial Expenses
Borrowing expenses will not be tax-deductible unless the acquirer demonstrates the existence of valid economic reasons for carrying out those transactions where they derive from debts generated within the corporate group (Article 42 of the Commercial Code) to acquire holdings in the capital or equity of any kind of entity from another company of the group, or to make contributions to the capital or equity of other group entities.

General Limit for Financial Expenses Deduction
Taxpayers can only deduct (as a temporary allocation rule) their net financial expenses (excluding the non-deductible financial expenses mentioned above) of the taxable period up to the limit of 30% of their operating profit (which corresponds to the company's EBITDA with certain adjustments), regardless of whether or not those financial expenses relate to intra-group indebtedness.

There is a EUR1 million threshold of net financial expenses that will be tax-deductible, regardless of the level of a company's operating profits in a given year.

In addition, if the amount of the net financial expenses incurred by a company in a given fiscal year is below the maximum tax-deductible threshold, the difference between the net financial expenses effectively deducted for CIT purposes and the maximum deductible amount may increase the "cap room" of that company (ie, the maximum amount deductible under the limitation rules) in the five fiscal years immediately following the year in which the difference arose.

The 30% limit would not apply if the company is dissolved or liquidated, unless it is due to the tax neutrality regime that applies to restructuring transactions.

These limitations will not be applicable to financial institutions and insurance companies.

Anti-LBO Rules

The CIT Act establishes that the EBITDA of the target entities that have joined the acquiring company's tax group or that have been merged with the acquiring company should be excluded when calculating the 30% EBITDA threshold to deduct the interest accrued by a Spanish acquiring company on the debt borrowed to acquire target entities.

This limitation will not apply if the amount of the purchase price financed with debt does not exceed 70% of the total purchase price, and if the acquisition debt is reduced to 30% or less in the following eight years, at least in an amount of one-eighth each year.

Hybrid Financial Instruments

Expenses arising from transactions with a related party will not be deductible if, at the recipient level and on the grounds of a different qualification for tax purposes, the proceeds of that transaction are not treated as income or are exempt or taxed at a nominal rate of less than 10%.

The return accrued on hybrid financial instruments representing share capital or equity of the issuer (for example, non-voting shares, redeemable shares) is to be characterised as a dividend for CIT purposes.

Profit Participating Loans (PPLs)

Interest accrued under profit participating loans granted to companies within the same group will be qualified as a distribution of profits by the borrower to the lender, and is therefore not deductible by the Spanish borrower. This new rule is applicable to financing granted after June 2014.

2.6 Basic Rules on Consolidated Tax Grouping

Spanish tax law sets forth the possibility of certain corporate groups being taxed on a consolidated basis.

To qualify as a group for these purposes, a Spanish resident company must own, either directly or indirectly, at least 75% (70% if the companies are quoted on the stock exchange) of its Spanish subsidiaries that are subject to CIT, and the majority of their voting rights.

Additionally, Spanish subsidiaries indirectly held through foreign companies are eligible companies. Similarly, two Spanish companies that have a direct or indirect common non-resident shareholder are allowed to form a tax group, as long as said shareholder is not resident in a tax haven for Spanish tax purposes.

PEs of foreign entities are permitted to become members of a Spanish group, provided certain requirements are met.

The controlling company's participation must be maintained throughout the entire tax period, and the controlling company must have been participating within the group regime from the first day of the tax period, except in the case of newly incorporated companies.

All of the companies in the group must have the same closing tax and financial period.

The consolidated tax regime is optional. However, if applying for this regime, all the eligible companies must be included within the group.

The group taxation operates according to the sum of the taxable bases of all the companies in the group, calculated according to the rules provided for individual taxation (ie, consolidated accounting rules are not considered for tax purposes). Additionally, the incorporation and elimination of intra-group transactions must be made in order to calculate the group's taxable base.

Finally, under the tax consolidation regime, obligations in connection with the documentation of related party transactions carried out with companies within the tax group may not be fulfilled.

2.7 Capital Gains Taxation

Capital gains are taxed at the general corporate rate of 25%, but capital gains arising from selling shares in other resident or non-resident corporations might be partially or totally exempt. The exemption regime may cover unrealised gains, under certain conditions.

The requirements that should be met in order for the exemption to be applicable are as follows.

Qualifying Shareholding in the Corporation

The Spanish shareholding corporation must have (i) a direct or indirect shareholding in the capital or equity of the resident or non-resident entity for which shares of at least 5% are transferred, or (ii) a minimum acquisition value of EUR20 million, along with an additional obligation which entails that the shares transferred at the time of the transaction should have been held by the shareholder at least continuously during the previous year.

In the case of indirect shareholdings, the CIT Act establishes a special rule for holding entities (ie, 70% of their income derives from dividends and capital gains from shareholdings).

In such cases, the Spanish shareholder should have an indirect 5% shareholding in the second and lower-tier shareholdings controlled by the holding entity, unless those second and lower-tier entities form a group of companies with the first-tier subsidiary or holding entity according to the Spanish Commercial Code (broadly, there is a group when a company holds or may hold, directly or indirectly, control of one or more companies).

Minimum Effective Taxation

A transfer of interest in a non-resident company should be subject to tax of an identical or similar nature to the CIT, at a nominal rate of at least 10%. This requirement is considered to be met when the non-resident entity is resident in a jurisdiction with a tax treaty with Spain that includes an exchange of information clause.

Furthermore, restrictions on this exemption are established by the CIT Act for the transfer of interest in passive entities ("*Entidades Patrimoniales*"), previously defined in **1.4 Tax Rates** as companies that are resident in a tax haven or non-resident corporations that qualify as Controlled Foreign Companies (CFC) – as defined in **5.5 Formulas Used to Determine Income of Foreign-owned Local Affiliates** – provided that 15% of its total income is considered as "passive".

If the participation exemption was not applicable, a tax credit may be applied to achieve the international double taxation relief.

2.8 Other Taxes Payable by an Incorporated Business

The transfer of assets by incorporated businesses would generally be subject to VAT and, as the case may be, Stamp Duty.

However, the transfer of real estate properties by incorporated businesses is subject to Transfer Tax if such a transfer is exempt from or not subject to VAT (eg, when real estate properties are included in a "going concern"). Tax on Increase in Urban Land Value (see below) may also be levied on these transactions.

The transfer of shares is normally exempt from VAT. However, Article 314 of the Securities Market Law (SML) sets forth a specific anti-avoidance rule that may be applicable to indirect transfers of real estate properties that are not used in a business activity, which under this rule may be subject to VAT or Transfer Tax as if real estate properties were being directly transferred.

Tax on Increase in Urban Land Value ("Impuesto sobre el Incremento del Valor de los Terrenos de Naturaleza Urbana")

This tax is levied on the increase disclosed in the value of urban land whenever land is transferred. The taxpayer is the transferor in transfers for consideration, and the transferee in donations. There is currently an important controversy over the legality of this tax. In this respect, both the Constitutional Court and the Supreme Court have ruled on cases in which the taxable event does not occur, despite the provisions of the tax law. It is possible that there will be new legal and/or doctrinal changes in the future.

2.9 Incorporated Businesses and Notable Taxes

Because of their importance, the following local taxes should be highlighted.

Tax on Business Activity ("Impuesto sobre Actividades Económicas")

This tax is levied annually on any business activity conducted within the territory of the municipality. The tax payable is calculated on the basis of various factors (type of activity, area of premises, net revenues, etc).

Tax on Real Estate ("Impuesto sobre Bienes Inmuebles")

This tax is levied annually on owners of real estate or on holders of rights in rem thereon, based on the cadastral value determined pursuant to the Property Cadastre regulations.

3. Division of Tax Base Between Corporations and Non-corporate Businesses

3.1 Closely Held Local Businesses

Individuals who intend to develop a business or professional activity may choose between undertaking it on a self-employed basis ("*autónomo*") or through a corporate form.

The facts that can be taken into account to decide are the limitation of liability for debts, and the costs required (minimum capital and administrative cost) in a corporate form.

From a tax perspective, it must be noted that any profits arising from certain small-sized economic activities could be calculated, if the activities are carried out directly by the individual (or through an entity subject to "income attribution regime"), as an objective estimate that, as a general rule, entails a more favourable tax treatment than the ordinary estimation method.

3.2 Individual Rates and Corporate Rates

The maximum Personal Income Tax (PIT) rates are higher than those of CIT, meaning that a company's income may have a more beneficial tax rate when compared to the tax rate for income obtained directly by the individual.

However, on an aggregated basis (ie, considering not only the tax cost at the corporate level, but also the tax cost arising from the distribution of profits to the individual), the two alternatives do not differ significantly.

In order to avoid benefits being left and used at the company level rather than distributed to the individual, Spanish tax legislation permits the tax administration to apply (i) arm's length valuation rules for related party transactions, and (ii) general anti-avoidance rules.

3.3 Accumulating Earnings for Investment Purposes

The CFC rules described under **6.5 Taxation of Income of Non-local Subsidiaries Under CFC-Type Rules** prevent non-resident closely held corporations from accumulating earnings for investment purposes, as investment income is typically subject to the CFC Rules.

No domestic CFC rules have been implemented in Spain to date.

Accumulating earnings may also lead to an entity being qualified as a passive holding entity ("*Entidad Patrimonial*") – as defined under **1.4 Tax Rates** – to the extent that such earnings are not used in a business activity. These entities have limited capacity to benefit from certain tax regimes (eg, participation exemption and newly incorporated and small/medium-sized companies).

Similarly, passive holding entities may be excluded from tax incentives linked to family-owned businesses set out for Wealth Tax and Inheritance and Gift Tax purposes.

3.4 Sales of Shares by Individuals in Closely Held Corporations

Capital gains or losses on the sale of shares in closely held corporations will also be subject to PIT, and are included in the savings tax base ("*Base imponible del ahorro*") and will be taxed at a rate of 19% on the first EUR6,000, 21% on amounts between EUR6,000 and EUR50,000, and 23% on amounts above EUR50,000. They are valued as the difference between the acquisition and transfer value of the shares transferred, and are taxed at the same rates as income derived from dividends (see above).

3.5 Sales of Shares by Individuals in Publicly Traded Corporations

Capital gains or losses on the sale of shares in publicly traded corporations will have the same rate of taxation as those derived from the sale of shares in closely held corporations.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

Interest

Interest and other income from Spanish-source loans is generally subject to taxation in Spain, unless an exemption is provided by the Spanish Law or a tax treaty.

The withholding tax rate applicable to Spanish-source interest paid to non-residents is 19% (in the absence of an applicable tax treaty rate).

Please note that certain exemptions are granted by the Non Resident Income Tax Act to certain types of interest income – ie, interest obtained by EU residents, interest derived from public-debt securities and from securities issued in Spain by non-residents, and interest from non-residents' bank accounts.

Dividends

Dividends and other income from participation in the equity of resident corporate bodies are subject to Withholding Tax in Spain, unless an exemption is provided by the Spanish Law or a tax treaty. Withholding Tax rates are the same as those applicable to interests.

Nevertheless, there are exemptions set forth for the following:

- dividends obtained by pension funds and collective investment institutions that are resident in the EU or the European Economic Area, provided that certain requirements are met;
- dividends paid by a Spanish subsidiary to its EU parent company, provided that certain requirements are met (including 5% interest or EUR20 million acquisition value, and that participation is held for the duration of at least one year); and
- dividends paid by a Spanish entity under the Spanish Holding Regime (ETVE Regime).

Royalties

Royalties paid by resident individuals or corporate bodies or PEs that are located in Spain, or royalties that are used in Spain, are subject to Withholding Tax in Spain, unless an exemption is provided by the Spanish law or a tax treaty.

The Withholding Tax rate applicable to Spanish-source royalties paid to non-residents is 19% for residents in the EU or the EEA, and 24% in all other cases.

Royalties paid by a Spanish resident company (or by a PE in Spain of a company resident in another EU Member State) to EU associated companies (ie, 25% of direct participation held during one year) or to a PE of an EU-resident company in another Member State are also exempt, provided that certain requirements are met.

4.2 Primary Tax Treaty Countries

Traditionally, the Netherlands and Luxembourg have been the jurisdictions of choice for entrance into equity investments in Spain by foreign investors. In particular, the tax treaty signed with the Netherlands contains a beneficial treatment of land-rich investments in Spain. However, this treaty is currently being renegotiated, and taxation at source in Spain is expected to be included in the new version.

This is despite the fact that, as a general rule, Spain does not currently tax capital gains or dividends (in the latter case, only if parent-subsidiary conditions are met) for any EU investors (other than Spanish investors).

In the case of debt, the decision is influenced mainly by the taxation in the home jurisdiction of the investor, as Spain does not levy tax against EU investors on any sort of interest arising in Spain, and there are also plenty of exemptions that can apply to other investors in qualifying bonds. The exemption is applicable worldwide in the case of public debt and debentures issued by listed companies or their subsidiaries (in the latter case, under certain conditions); this includes investors from tax havens.

4.3 Use of Treaty Country Entities by Non-treaty Country Residents

Two different situations must be assessed: the use of treaty country entities either with or without economic substance.

In the first case, these situations are not usually challenged by the tax authorities.

However, in the case of the use of treaty country entities without economic substance, Spanish tax authorities may apply two mechanisms:

- the general anti-abuse rules (sham transactions fraus legis, or abuse of Law – "*conflicto en la aplicación de la norma*"); and
- the particular mechanisms set forth in the tax treaties to avoid double taxation (eg, beneficial ownership).

The use of general anti-abuse rules is much more common.

In addition, treaty shopping is often not particularly obvious, and investors have usually taken the relevant precautionary measures to ensure that the intermediate vehicle can be seen as being fully entitled to treaty protection. However, special attention shall be paid to the impact in the Spanish courts and tax administration of the European Court of Justice Doctrine on anti-abuse tax legislation and beneficial ownership (contained in the so-called "Danish Cases").

4.4 Transfer Pricing Issues

One of the main issues for investors, especially those who are subject to specific reporting compliance, is the uncertainty of transfer pricing adjustments as a result of a Spanish tax audit procedure.

4.5 Related-Party Limited Risk Distribution Arrangements

Local tax authorities will challenge the use of related party limited risk distribution arrangements for the sale of goods or the provision of services locally, particularly when the limited risk distribution has been implemented as part of a group restructuring. It is recommended that these types of agreements are reached prior to implementation via an Advance Pricing Agreement with the tax authorities.

Furthermore, where manufacturing operations are also undertaken locally, the inspection may challenge the whole structure, even where it is clear that the restructuring has been undertaken with solid business reasoning.

4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards

The Spanish transfer pricing rules are in line with the OECD guidelines on the subject and the recommendations of the European Forum on Transfer Pricing, and should be interpreted in association with these guidelines and recommendations.

These rules explicitly establish the general obligation on taxpayers to apply the arm's length principle for all transactions carried out with related companies, and shifts the burden of proof to them. They also establish a general obligation to document all related party transactions carried out by taxpayers, and set forth a specific penalty regime.

5. Key Features of Taxation of Non-local Corporations

5.1 Compensating Adjustments When Transfer Pricing Claims are Settled

Spanish tax legislation expressly recognises the possibility of agreeing on a refund of the relevant amount of the difference between the fair market value and the challenged applied price, in order to avoid the secondary adjustment.

In principle, there should not be significant difficulties in operating a Mutual Agreement Procedure (MAP) where a Transfer Pricing Claim applies. However, a MAP may be rejected in the following circumstances:

- when it deals with internal law instead of a divergence in the application or interpretation of the Convention; or
- when it becomes apparent that the taxpayer was intending to avoid taxation in any of the states involved.

5.2 Taxing Differences

Branches are normally considered to be PEs by Spanish tax legislation, and are generally taxed in Spain under similar rules to those applicable to subsidiaries, on their net income.

The taxable base of the branches will be determined according to the provisions of the general CIT, including the possibility of carrying losses forward, with some specific rules such, as the non-deductibility of certain payments made to the head office, and the deductibility of the reasonable part of the general management and administration overhead expenses charged by the head office to the branch.

A branch is also subject to a Branch Profits Tax (19%) on the remittance of profits to a head office that is not an EU resident or that is resident in a country that has concluded a tax treaty with Spain that does not provide otherwise, subject to reciprocity.

5.3 Capital Gains of Non-residents

The Spanish NRIT Act states that capital gains on the sale of securities issued by Spanish residents or on rights or participations in entities (resident in Spain or not) that grant control over real estate situated in Spain are subject to taxation in Spain.

However, capital gains on holdings owned by residents of other EU Member States (except tax havens) that were not obtained through a PE are tax-exempt in Spain. Nevertheless, an exception applies for Spanish land-rich companies, qualifying shareholding (25%) of individuals and non-resident entities, if the transmission does not meet the requirements for the application of the exemption provided by Article 21 of the CIT (see **2.7 Capital Gains Taxation**).

Additionally, there is a tax exemption for capital gains arising from the transfer of securities or the reimbursement of participations in investment funds on official secondary securities markets in Spain.

Under the ETVE Regime (foreign securities holding entities), capital gains (including unrealised gains and goodwill) may not be subject to taxation in Spain.

Even though the OECD model tax convention provides a general rule for the taxation of capital gains, under which capital gains are taxed in the country of residence of the transferor (which would avoid taxation in the sale of stock in local corporations), Spain has also entered into several treaties in which it has reserved the right to tax capital gains of shares or rights.

5.4 Change of Control Provisions

Please see **5.3 Capital Gains of Non-residents**.

Spanish anti-avoidance rules may be used to challenge purely artificial structures that seek to evade taxation upon the transfer of shares in Spanish resident companies by means of a chain of void companies in different jurisdictions. Besides, another anti-avoidance rule is stated in article 314 SML, as referred to in **2.8 Other Taxes Payable by an Incorporated Business**.

5.5 Formulas Used to Determine Income of Foreign-owned Local Affiliates

There are no specific or defined formulas.

5.6 Deductions for Payments by Local Affiliates

Transfer pricing inspections with respect to management and administrative expenses tend to focus on the current costs charged to the local affiliate, seeking a disallowance of those costs that do not provide a benefit to the local affiliate. As such, the Spanish tax authorities prefer a direct charge allocation method over allocating costs based on any other such criteria.

5.7 Constraints on Related-Party Borrowing

A general limit for financial expenses deduction is imposed on foreign-owned local affiliates, which is applicable regardless of whether or not those financial expenses relate to related party borrowing.

Related party borrowing is limited by the application of transfer pricing rules as well as in the particular cases of hybrid instruments, PPLs and intra-group leveraged acquisitions (as shown in **2.5 Imposed Limits on Deduction of Interest**).

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

According to the CIT Act and without prejudice to the provisions of the relevant treaties to avoid double taxation, foreign income (other than dividends and capital gains, as explained below) obtained by local corporations is taxed, in principle, at the general rate previously discussed (25%).

There may be a differentiation between income from a foreign source obtained directly and income obtained through a source with a PE.

Income Obtained Through a PE

The CIT Act provides for a total exemption for the avoidance of double taxation that is applicable to income from business activities carried out abroad through permanent establishments. The requirements are identical to those for the application of the participation exemption explained in **6.3 Taxation on Dividends from Foreign Subsidiaries** and **6.7 Taxation on Gain on the Sale of Shares in Non-local Affiliates** (ie, business activity, identical or analogous tax and not located in a tax haven).

Negative income obtained abroad through a PE or upon the transmission of a PE is not included in the taxable base, except in the cessation of activity. In such a case, losses may be tax deductible to the extent they exceed exempt income previously obtained.

If the exemption is not applicable, foreign income is subject to taxation in the hands of the local corporation; in this event, tax relief may be available to avoid double taxation (the tax credit method).

Income Not Obtained Through a PE

Foreign income is subject to taxation at the level of the local corporate tax, and a tax relief to avoid double taxation may be of application in similar terms as discussed in the case of income obtained through a PE.

The CIT Act provides for a partial exemption of income arising from certain intangible assets ("patent box", as explained in **2.2 Special Incentives for Technology Investments**).

6.2 Non-deductible Local Expenses

There are some special rules (of a technical nature) set out by the CIT Act that constrain the deduction of losses connected to exempt income, and seek to prevent the absence of taxation, as follows:

- the deductibility of losses obtained as a result of a transfer of the interest in a company that qualifies for the participation exemption regime, unless the company is wound up or does not meet the minimum taxation requirement (as explained in **2.7 Capital Gains Taxation**); and
- the deductibility of losses obtained as a result of a transfer of the interest in a company will be reduced in an amount equal to:
  - (a) the exempt dividends received from that company (since 2009); or
  - (b) the exempt capital gains obtained in previous acquisitions from another company belonging to the same group of companies (in the sense of Article 42 of the Commercial Code) of the shares that are subsequently transferred.

6.3 Taxation on Dividends from Foreign Subsidiaries

In principle, taxes on dividends paid by shares in non-local subsidiaries are taxed at the ordinary CIT rates. However, double taxation relief mechanisms may reduce final taxation levels.

The Spanish CIT Act provides two alternative methods to avoid international double taxation: (i) the exemption method (explained in **2.7 Capital Gains Taxation**), and (ii) the tax credit method (applicable as a general rule when the requirements set forth for the exemption method are not met).

Regarding the tax credit method, dividends received from foreign subsidiaries are computed in the tax base (including the amount of the tax paid abroad) for calculating the tax due. Once the tax due has been calculated, the two different tax credits must be differentiated, as follows.

Tax Credit on Withholding Tax Borne

The Withholding Tax borne abroad will be deducted from the tax due, up to the limit of the tax that would have been payable on the dividend had it been obtained in Spain.

Tax Credit on Dividend's Underlying Tax

The underlying tax will be deducted where it was effectively paid by the non-resident entity in respect of the income out of which the dividends or profit participations were paid. This deduction, together with the tax credit on Withholding Tax borne, cannot exceed the gross tax that would have been payable in Spain on that income.

To qualify for the tax credit, a direct or indirect holding of at least 5% in the capital of the non-resident entity, or the acquisition value of which exceeds EUR20 million, must be owned without interruption for the one-year period immediately prior to the distribution of the dividend (or the one-year period must be completed after the distribution), and the resident entity must include in its tax base not only the income distributed but also the taxes borne by those foreign entities.

6.4 Use of Intangibles

Considering the special valuation rule of transactions among related parties, income obtained by a local corporation as a result of the assignment of intangibles to a subsidiary must be valued according to the arm's length principle, and will therefore be subject to taxation in the hands of the local corporation.

Notwithstanding the above, and as noted in **2.2 Special Incentives for Technology Investments**, Spanish CIT law provides for a "patent box regime", where up to 60% of the net revenue derived from the licensing (not direct use) of certain intangibles will not be included in the tax base of the Spanish taxpayer if certain requirements are met.

6.5 Taxation of Income of Non-local Subsidiaries Under CFC-Type Rules

CFC rules apply to foreign subsidiaries controlled by a local corporation that has been subject to a tax that is lower than 75% of the tax that would have been paid under Spanish CIT rules.

Spanish tax law sets out an imputation rule under which the "total income" (and not only the passive income) of a CFC entity should be attributed to the Spanish controlling shareholder. However, this rule only applies when the CFC entity does not have enough "substance" to carry out its activity.

When the subsidiary has "substance", only certain types of income (in general, passive income) are subject to the CFC rules.

CFC rules provide for a safe harbour (ie, where the total income subject to the CFC rules – other than income from the provision of services and insurance and financial activities – is less than 15% of the profits of the CFC) that, unless exceeded, precludes the application of the CFC rules.

In the case of holding companies, CFC rules will not apply to income derived from real property owned by a non-resident affiliate, dividends and capital gains from shareholdings where the following substance requirements are met:

- the CFC directly or indirectly holds at least 5% of another non-resident company;
- the CFC engages directly in the management and administration of the interest in the affiliates (and not the business activity of the affiliates), with the necessary material and human resources; and
- at least 85% of the income of the non-resident entity is derived from an active business.

No CFC rules will apply to entities that are resident within the EU (even though they obtain passive income), provided that the taxpayer can demonstrate that the CFC was set up for valid economic reasons and is engaged in business activities.

As branches or permanent establishments located abroad have no legal personality that differs from the resident entity to which they belong, their yields are taxed directly in the Spanish territory, so it is meaningless to apply the CFC regime.

6.6 Rules Related to the Substance of Non-local Affiliates

The "total income" (and not only the passive income) of a CFC entity should be attributed to the Spanish shareholder when the CFC entity does not have enough "substance" (that is, human and material resources) to carry on its activity.

6.7 Taxation on Gain on the Sale of Shares in Non-local Affiliates

Taxes on the gains of the sale of shares in foreign subsidiaries are, in principle, implemented at the ordinary CIT rates. However, double taxation relief mechanisms may reduce final taxation.

As in the case of dividends, double taxation relief may alternatively be achieved through an exemption or the tax credit method.

The Spanish CIT Act provides an exemption regime for capital gains arising from the transfer of securities representing the equity of entities that are not resident in Spain and qualify for the exemption regime on dividends of foreign source (see **2.7 Capital Gains Taxation**).

7. Anti-avoidance

7.1 Overarching Anti-avoidance Provisions

The Spanish General Tax Act provides two general anti-avoidance rules (GAAR), which are set forth in Articles 15 and 16, respectively.

Article 15 of the Spanish General Tax Act sets forth a general mechanism for combatting tax fraud. Fraud is deemed to exist where a taxable event is partially or completely avoided, or where the taxable income and/or tax liability is decreased by means of actions or transactions that, considered individually or collectively, are manifestly artificial or inappropriate for achieving the result obtained, or whose their use does not have relevant legal or commercial effects other than tax savings and the effects that would have been obtained by means of the usual acts or transactions. Therefore, for the tax administration to be able to declare the acts or transactions to have been performed fraudulently (avoidance transactions), it must be evidenced that they are manifestly artificial or inappropriate for the purpose of achieving the result obtained, and that these acts or transactions have not been performed for valid commercial or legal reasons other than to obtain tax savings.

The other general anti-abuse provision is included in Article 16 of the Spanish General Tax Act and sets forth a provision whose purpose is to correct the effects of a tax sham.

A sham transaction exists where another different business purpose is concealed under the guise of a normal legal transaction, which may be contrary to the very existence of the transaction ("absolute sham"), or aimed at the performance of another different transaction ("relative sham"). The sham involves a desired and deliberately provoked discrepancy by the parties between its true will and what it externally manifests, for the purpose of creating a legal appearance concealing this will from third parties.

8. Other

8.1 Regular Routine Audit Cycle

There is no special rule on the audit cycle that enables taxpayers to anticipate accurately when they are going to be tax audited. However, there are some practice rules that must be considered in order to understand the routine related to the tax audit cycle.

It is important to note that the statute of limitations in connection with the audit cycle in Spain is four years (five to ten years in the case of penal prosecution). Large companies are, in practice, under permanent audit, whereas individuals and any small or medium-sized companies are only subject to a tax audit depending on certain factors, which will be outlined below.

Tax audits may occur as a result of the guidelines contained in the "Annual Inspection Plan", in which the tax authorities outline certain sectors, activities or types of companies that may be audited during the tax year, in line with the international trends.

A tax audit may take place in response to information that has been made available to the tax authorities by other entities under the obligation to supply information. Spain has developed an information collection system that provides a large amount of information on taxpayers which, in many cases, is the origin of many tax revisions.

9. BEPS

9.1 Recommended Changes

Spain implemented most of the BEPS actions in domestic tax legislation with the corporate tax law, which has applied since 1 January 2015. Many of these changes have already been addressed (eg, hybrid mismatches, CFC rules, interest deduction, transfer pricing, patent box).

Additionally, Spain was one of the signatories of the OECD multilateral convention to implement tax treaty-related measures to prevent BEPS (MLI), signed on 7 June 2017. Spain's definitive position on the MLI is still to be approved by the Spanish Parliament.

On 21 June 2016, Spain also signed the "Multilateral Competent Authority Agreement on the Exchange of Country-By-Country Reports" (CbC MCAA), and has currently activated 59 exchange relationships for country-by-country reporting on the basis of the CbC MCAA, the EU Council Directive 2016/881/EU and bilateral competent authority agreements for exchanges of information signed with other countries.

Further developments are currently being discussed in the Spanish Parliament to implement measures contained in Directive 2016/1164 as amended by Directive 2017/952 (ATAD I and ATAD II). The draft bill recently published addresses those amendments that need to be implemented in short (ie, exit tax and CFC rules), and refers to future modifications of the tax rules applicable to hybrid mismatches and the deductibility of financial expenses.

9.2 Government Attitudes

The Spanish tax administration played an active role in the work-groups created in the context of BEPS for the study of the 15 actions, and has consistently shown a high level of commitment to the implementation of the measures proposed. Some of these measures were domestically implemented even before the 2015 final reports were released.

The objective of the government is to implement the measures agreed in BEPS fully and promptly.

9.3 Profile of International Tax

International tax issues are increasingly important for the Spanish tax administration, especially as a result of the participation in BEPS. For that reason, a National Bureau of International Tax Affairs was created in 2013 to manage, plan and co-ordinate international tax affairs.

In particular, the Bureau will monitor the following risk areas – as stated in the annual tax fraud control plan – directly connected to BEPS:

- control of transactions carried out by Spanish tax residents using hybrid mismatch or other aggressive tax planning arrangements;
- control of leveraged acquisition of participations with the main aim of generating tax-deductible expenses;
- control of transactions carried out with low-tax countries (especially those qualified as tax havens) and by persons or entities that change their residence with the aim of avoiding the payment of taxes;
- control of payments and complex transactions to which model provisions to prevent treaty abuse, including through treaty shopping, may be applicable; special attention will be drawn to dividends and royalties paid through "conduit companies" set up in countries with favourable tax treaties to channel investments and obtain reduced rates of taxation;
- control of permanent establishments of non-resident entities that are currently being taxed as if they were not established in Spain for tax purposes, especially in the cases of multinational enterprises; and
- the effectiveness of information exchange and co-operation between tax administrations.

9.4 Competitive Tax Policy Objective

The Spanish government does not have a competitive tax policy as a priority. Furthermore, its priority is fully aligned with BEPS objectives, and seeks to prevent abusive tax practices that erode the tax revenues of the Spanish Administration.

9.5 Features of the Competitive Tax System

There are no tax benefits at risk, since all are fully compliant with EU and OECD principles.

9.6 Proposals for Dealing with Hybrid Instruments

The Spanish tax administration has already implemented rules in relation to the tax treatment of hybrid instruments.

Additional measures on hybrid mismatches have not yet been included in the ATAD I and ATAD II implementation package that is currently under discussion. The complexity of these measures and the availability of implementation periods (up to 31 December 2019 and/or 31 December 2021) have led the Spanish government to postpone them.

9.7 Territorial Tax Regime

Spain does not have a territorial tax regime. Many of the interest deductibility proposals have been already implemented in Spain.

9.8 CFC Proposals

Spain does not have a territorial tax regime. In general terms, CFC rules may not be compatible with certain double taxation conventions, especially in those cases where the convention grants an exemption on dividends.

Moreover, a "sweeper" CFC rule that allocates income regardless of the substance located in a particular jurisdiction may not be compatible with the EU principles of freedom of establishment and free movement of capital.

Spanish tax law has already introduced a new imputation rule under which the "total income" (and not only the passive income, as it used to be) of a CFC entity should be attributed to the Spanish controlling shareholder. However, this new rule considers this potential incompatibility and only applies when the CFC entity does not have sufficient "substance" to carry out its activity.

9.9 Anti-avoidance Rules

Anti-treaty abuse provisions like the "beneficial ownership" clause are already present in most of the treaties already signed by Spain, so new measures in this regard will not mean a significant change.

Through its (provisional) MLI position, Spain has adopted the Principal Purpose Test for protection against the abuse of tax treaties. Similar clauses are being included in new tax treaties signed by Spain.

9.10 Transfer Pricing Changes

Spanish transfer pricing legislation and case law already in place are aligned with OECD standards, and changes proposed by BEPS do not entail significant modifications.

Rules regarding international transactions between related companies (eg, the use of intangibles, and the allocation of benefits to permanent establishments) are increasingly drawing the attention of the Spanish tax inspection, and may need further development to provide legal certainty to multinational groups.

9.11 Transparency and Country-by-country Reporting

Spain has already adopted the OECD recommended country-by-country reporting requirements, in line with the conclusions of the discussion draft of Action 13. This obligation affects Spain-based multinational entities with a turnover of EUR750 million or more, which are required to file the report in the 12 months following the close of the fiscal year.

The foreword of the Spanish regulation specifically states that CbC reporting should not be used by tax administrations to propose transfer pricing adjustments, which was one of the main ideas of the proposal contained in Action 13.

It is understood that the implemented measures will help to achieve the BEPS objective to provide tax administrations with the information necessary to conduct an informed transfer-pricing risk assessment. This new requirement will increase certainty and predictability in relation to transfer-pricing audits.

One of the main concerns relates to the confidentiality of the information contained in the report and the appropriate way to share such information with the tax authorities of other countries.

Additionally, documentation requirements put in place may not be respectful of the objective of being less burdensome and more targeted.

9.12 Taxation of Digital Economy Businesses

At present, benefits generated by digital economy businesses operating from outside Spain are not subject to a specific tax.

However, the Spanish government has released a preliminary draft bill on a new digital services tax (DST) that would align with the draft EU Directive presented by the European Commission on 21 March 2018.

The new DST is construed as an indirect tax of 3% levied on the gross revenue obtained in Spain from certain services where the participation of a user in a digital activity constitutes input for the business and enables it to obtain revenues therefrom.

This tax would only be charged on entities with a total worldwide revenue exceeding EUR750 million and Spanish-source taxable revenue exceeding EUR3 million.

9.13 Digital Taxation

Spain has not yet performed additional legislative development regarding digital taxation, other than the draft bill on digital services tax explained in **9.12 Taxation of Digital Economy Businesses**.

However, the Spanish tax authorities are willing to take the necessary measures in this field.

9.14 Taxation of Offshore IP

Spain has not introduced specific provisions dealing with the taxation of offshore intellectual property. However, the Spanish tax authorities have normally addressed situations in which a taxpayer opts to assign IP rights to offshore companies by the application of GAAR (please see **7.1 Overarching Anti-avoidance Provisions**), transfer pricing rules (please see **4.6 Comparing Local Transfer Pricing Rules and/or Enforcement and OECD Standards**), and CFC rules (please see **6.5 Taxation of Income of Non-local Subsidiaries Under CFC-Type Rules**).

9.15 Other General Comments

As previously mentioned, Spain strongly supports this BEPS exercise and has been and will be very proactive in the domestic implementation of the recommended changes to the tax law.

GTA VILLAMAGNA offers high-quality and integral legal services with an international focus, tailored to clients' needs, and covering a wide range of practice areas. The firm is based in Madrid but co-operates with law firms in a large number of countries, enabling it to offer clients an international service. It is active in the areas of commercial and civil law, tax law, public law, litigation, insolvency law, M&A, and economic crime law. The Tax Department is made up of a compact but highly respected team of 16 tax lawyers, who have immense knowledge and experience in a wide variety of tax matters. The team provides advice on tax litigation, general taxation, wealth management, private banking, financial transactions, and real estate.

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