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Feature Story

Spanish Holding Company Emerging As Useful International Tax Planning Tool



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When companies hold or plan to hold interests in subsidiaries resident in foreign jurisdictions, appropriate international tax planning is a must. Though some might argue that going abroad can give more than one headache to the client and its counselors, problems may be avoided if a friendly jurisdiction and the right local counsel are chosen. The amount of money – and inconvenience – that can be saved is well worth it.

This article provides an overview of the Spanish holding company. While the Spanish holding company regime is newer than those in the Netherlands and Luxembourg, it offers considerable tax advantages for companies with international business and investments.



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The Spanish holding regime is highly tax efficient and strongly competitive with other European holding regimes. It is recommended for consideration when centralizing the investments of international groups. It also is a natural holding location for investments in Latin American subsidiaries.

International groups should take a close look at Spain before incorporating any international holding company.

The Spanish holding company, also known as *Entidad de Tenencia de Valores Extranjeros*, or ETVE, is a legal entity, subject to the Spanish Corporate Income Tax (CIT) at the general tax rate of 35 percent.



However, provided certain requirements are met, the ETVE can benefit from tax exemptions on inbound and outbound dividends, as well as inbound and outbound capital gains – that is, capital gains obtained by the ETVE when selling shares in its non-resident subsidiaries, and capital gains realized by members of the ETVE when selling their shares in the ETVE.

Additionally, the ETVE can benefit from the extensive Spanish international tax treaty network, as well as from the provisions set forth in the EU Directives.

The Spanish Corporate Income Tax Act (CITA) introduced the legal framework for the ETVE in 1995. Subsequent improvements have positioned the ETVE as a competitive international tax-planning alternative to other European holding regimes.

Furthermore, the ETVE is not on the Harmful Tax Practices list elaborated by the Primarolo Group in what is known as the International Tax Code of Conduct.

Requirements

In general terms, to be considered "qualifying subsidiaries," which allow the ETVE to enjoy tax benefits, the ETVE's subsidiaries must comply with the following requirements.

First, the ETVE must have direct or indirect ownership of at least 5 percent in the share capital of one or more subsidiaries non-resident in Spain. However, ownerships below 5 percent may qualify if the value at their acquisition is above 6 million euros.

Second, the share ownership described above must have been held by the ETVE for an uninterrupted period of at least 12 months. Significantly, the dividend exemption applies even if the uninterrupted ownership period is fulfilled after the dividend has been distributed.

Third, a qualifying subsidiary must be subject to a tax regime of identical or analogous nature to the Spanish CIT, although there is no minimum tax rate required. The Spanish legislation presumes this requirement to be fulfilled if the subsidiary is resident in a country that has concluded a tax treaty with Spain containing an information exchange clause. Subsidiaries resident in a jurisdiction considered a tax haven are ineligible.

Fourth, at least 85 percent of the income of the foreign subsidiary must derive from active business activities performed outside of Spain. The following sources are considered eligible active business activities: non-passive (CFC) income; wholesale trade; services; credit; financial; insurance and reinsurance transactions carried out through the organization of human and material resources in non-Spanish territory; and dividends and capital gains obtained from other qualifying subsidiaries.

Advantages

Treated as tax exempt in Spain are the dividends distributed by the "qualifying subsidiaries" to the ETVE, capital gains obtained by the ETVE from the alienation of the shares of the "qualifying subsidiaries," and capital gains generated by the alienation of the shares of the ETVE.

Also, dividends distributed by the ETVE to its shareholders out of income generated by qualifying subsidiaries are not considered sourced in Spain, and therefore are not subject to Spanish withholding tax. Furthermore, no withholding tax applies on the distribution of the share premium by the ETVE to its direct foreign shareholders.

It is important to bear in mind that when the acquirer of the ETVE shares (or the acquirer of shares in a subsidiary from the ETVE) is a resident in a tax haven jurisdiction, the tax exemption on capital gains does not apply. (As noted above, the sale of shares in a subsidiary resident in a tax haven jurisdiction also is not exempt from taxation.) Similarly, the tax exemption on dividends from the ETVE does not apply when the recipient resides in a tax haven jurisdiction.

From the tax point of view, the following general rules apply to every company in Spain, and therefore also to the ETVE.

For Spanish tax purposes, interest paid for the acquisition of shares is deductible, regardless of what kind of company the borrower is. Consequently, if in order to acquire shares of other companies the ETVE incurs indebtedness, it will get a complete deduction for the interest on the loans.

Spanish tax regulations do not restrict the deductibility of the capital losses generated in the sale of stakes in other companies. Therefore, should the ETVE suffer losses when selling any of its stakes, the losses would be completely deductible.

The financial goodwill generated in the acquisition of a stake in a qualifying subsidiary can be depreciated for tax purposes over a period of 20 years. Financial goodwill is understood to be the difference between the price or value by which the shares were acquired and their net asset value.

The capital tax in Spain is 1 percent, but there are exceptional situations where it does not apply, especially concerning contributions in kind. For example, the contribution of qualifying subsidiaries' shares to an ETVE is completely tax-exempt.

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