The CFC regime for Spanish companies investing in Latin America and elsewhere

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Outline

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I. Introduction
CFC regimes around the world

• Legislative goals
  
  – Created to help prevent tax evasion or deferral through the foreign companies in jurisdictions with little or no taxation:

    ▪ Anti-deferral provisions
    ▪ Specific anti-abuse rules (Spain)
CFC regimes around the world

• **Types of CFC regulations**
  
  – Entity approach: allocation of the subsidiary’s entire income (e.g. France, the United Kingdom)
  
  – Transactional approach: allocation of only certain tainted income; i.e. in general, passive, shifted or delocalized income (e.g. US, Germany or Spain)
II. Overview of Spanish investments in LATAM
Advantages of Spanish Holdcos: “ETVE”

A brief reminder:

- **Largest tax treaty network in LATAM** (some providing specific and unique tax advantages)
- More bilateral investment treaties (BIT) in LATAM than any other country
- Highly favorable **participation exemption** regime for dividends and capital gains; tax exemption of branch profits
- Not considered a tax haven in any LATAM country
- Attractive and stable holding tax regime
## Spanish tax treaty and BIT network in LATAM

### Treaties in force (16)
- Argentina *
- Barbados
- Bolivia *
- Brazil
- Chile *
- Colombia *
- Costa Rica *
- Cuba *
- Ecuador *
- El Salvador *
- Jamaica *
- Mexico *
- Panama *
- Trinidad and Tobago *
- Uruguay *
- Venezuela *

### Under negotiation (4)
- Peru (signed) *
- Dominican Republic *
- Honduras *
- Guatemala *

*Countries that also have a BIT with Spain. Bolivia to be reviewed*
Main Features of Spanish ETVEs

- Standard Spanish company
- **Participation exemption.**

Dividends / Gains deriving from non-resident subsidiaries are exempt from Spanish Corporate Income Tax (“CIT”) 0% IN

Requirements:

- Shareholding ≥ 5% (or acquisition value > EUR 6 million) and 1-year holding
- Foreign subsidiary subject to tax (CIT equivalent) or resident in a tax treaty jurisdiction
- At least 85% of income derives from an **active business** outside of Spain (not CFC tainted income)
Main Features of Spanish holdcos

- **Dividend distribution.**
  Dividends paid by the ETVE out of qualifying foreign income to non-resident shareholders are not subject to withholding in Spain. **0% OUT**

- **Transfer / Liquidation.**
  No Spanish taxation of non-resident ETVE shareholders upon exit. **0% ON EXIT**
Summary of an ETVE’s structure

**GAINS**

- Gains triggered by the ETVE’s non-resident shareholders are not taxable in Spain
- Gains derived from qualifying foreign subsidiaries are exempt at the ETVE level under the Spanish domestic participation exemption regime
- Gains from qualifying foreign subsidiaries may be exempt in the source country under the relevant tax treaty or domestic regulations (e.g. Netherlands, Luxembourg, Colombia, and Venezuela)

**DIVIDENDS**

- Dividends received by the ETVE’s non-resident shareholders are not taxable in Spain
- Dividends from qualifying subsidiaries are exempt at the ETVE level under the participation exemption
- Reduced WHT on dividends distributed by subsidiaries under tax treaty network / EU Directives
Spanish Opcos investing in LATAM

- Benefit from:
  - The tax treaty network with LATAM countries
  - The protection of BITs with LATAM countries
  - The participation exemption regime for dividends and capital gains; the tax exemption for branch profits
- Subject to CFC regulations and limitations
- Existing Spanish OPCOs can apply for ETVE (holding) status and benefit from the above features (e.g. tax-free distribution of exempt dividends and gains to foreign shareholders)
III. CFC Regulations in Spain
Spanish regulations

• In general, tax residents must include income obtained by foreign affiliates subject to specific conditions in their tax return:
  – qualifying interest
  – tax regime
  – listed types of income
Definition of CFC

• Non-resident entity
• Direct or indirect control (related parties)
• 50% or more of the share capital, net equity, results (profits), or voting rights
• Subject-to-tax: foreign tax paid on CFC income must exceed 75% of the Spanish tax (in general, 22.5%, but there is a participation exemption)
Excluded from CFC definition

- CFC regime is not applicable to EU entities:
  - if the taxpayer evidences that the CFC was incorporated for valid economic reasons and engages in active business
    - Difference vs. income tax for natural persons
- Not applicable to branches, other PEs or transparent entities
- Spain has no specific CFC blacklist (however, please see provisions on tax havens)
Tained income

Passive income from:

- Lease and ownership of real property (exceptions)
- Dividend income
- Capital gains (real property and shareholdings)
- Interest and income from lending activities
- Income from the provision of services, insurance and financial activities (when payment is tax deducted by a Spanish related taxpayer); and
- Other (residual)
Attribution of tained income

- CFC status is determined at the end of the tax year
- Attribution of income is made on the basis of the interest held by each shareholder:
  - Directly or indirectly (not only through related parties)
  - Regardless of the CFC’s dividend distribution policy
- Income is generally allocated the “current” tax year
- Taxpayer may opt to allocate income to the following tax period
Tax credits and double taxation

- Dividends paid out of income that has already been attributed under CFC rules (i.e. already taxed in Spain) are not subject to tax in Spain when effectively distributed.
- Taxes previously paid by the CFC may be credited by the Spanish shareholder to whom the CFC’s income is allocated.
- Taxes paid in tax havens may not be credited.
Tax credits and double taxation

- Tax credits for Spanish income tax purposes:
  - Foreign income tax effectively paid by the CFC and its subsidiaries on income subject to attribution (requires 5% interest; not available to natural persons)
  - Foreign withholding tax deducted on dividends paid out of profits previously subject to attribution
  - Credit is limited to the amount of Spanish tax corresponding to attributed income
Exceptions to the CFC regime

- **De minimis amounts**
  - Tainted income is less than 15% of the CFC’s profits
  - Tainted income is less than 4% of the CFC’s total income
    - For these purposes, tainted income does not include financial, insurance or other services
    - Option to compare with the group CFC’s profits or income

- **Participation exemption**
  - Dividends and capital gains from shareholdings:
    - 5%, one year of ownership, management of interest
    - At least 85% of foreign-sourced active income
  - Real estate subsidiaries included
Exceptions to the CFC regime

• Intra-group financing
  – CFC rules do not apply to interest where:
    ✓ both entities belong to the same group
    ✓ lender derives 85% of active income
    ✓ Interest is not deducted by a Spanish taxpayer

• Financial activities and services “safe harbor”
  – CFC rules do not apply to income from services, insurance and financial activities (when payment is tax deducted by a Spanish related taxpayer) if:
    ✓ the CFC derives more than 50% of its income from non-related parties (export-related activities excluded)
Exceptions to the CFC regime

- **Export-related expenses**
  - CFC rules do not apply to income from services, insurance and financial activities (when payment is tax deducted by a Spanish related taxpayer) if:
    - ✓ they are directly related to export activities by the taxpayer

- **Others already analyzed**
  - **Services and others:**
    - ✓ expense non-deducted by Spanish taxpayer
    - ✓ rendered to non-related party in Spain or abroad
  - **EU affiliates and branches:** see above
  - **Financial assets:** e.g. certain promissory notes
Sale of the CFC and other features

• Attributed tainted income will increase the shareholder’s tax basis (unless further distributed)

• Quantification of tainted income to be attributed is made according to Spanish rules. FX rate at the last day of taxable year

• In general, losses are not attributed

• CFC is deemed compatible with tax treaties
CFC located in tax havens

- Presumption (*iuris tantum*) that CFC income exists and must be attributed, amounting to 15% of the CFC’s acquisition cost
  - Not applicable in case of accounting consolidation
  - The list of Spanish tax havens is being reduced:
    - New TIEAs: Andorra, Netherlands Antilles, Aruba, Bahamas and San Marino; Cayman and others to come
    - New tax treaties: e.g. Hong Kong and Singapore
IV. Tax planning opportunities and examples
• **Dividends** distributed to ETVE shareholders and **capital gains** upon ETVE transfer: **not taxed in Spain**

• Foreign branch income -including **royalties** and **interest** payments derived from subsidiaries or other entities- is **exempt at the ETVE level**

• Under the OECD approach, generally accepted in Spain and abroad, third-party payments to the Foreign Branch (Swiss, Irish, Luxembourg, USA) are subject to **reduced withholding** rates in accordance with Spanish tax treaties.

• Brazil takes a different approach for interest payments ("triangular clause") neutralized by domestic regulations. It works for royalties (but “Volvo case 1”)

*General description. Financial entities and others may enjoy lower rates on interest payments. Royalty rates depend on the nature of services.*
• **Dividends** distributed to USCo and **capital gains** upon ETVE1 transfer: not taxed in Spain

• Dividend income and capital gains derived from ETVE2 are exempt at the ETVE1 level

• Capital gain realized on the transfer of ETVE2 (indirect transfer of BraCo): no tax on Brazil

• Dividends distributed to the ETVE2 by BraCo: No tax (domestic regulations). Although a 15% withholding tax may be imposed in the future, a 10% withholding will apply under the Spanish tax treaty

• **Most Favored Nation** clause for dividends and royalties and tax sparing clause for interest
Brazil (II)

- **Dividends** distributed to USCo and **capital gains** upon ETVE1 transfer: not taxed in Spain

- Dividend income and capital gains derived from DutchCo are exempt at the ETVE1 level

- Capital gain on transfer of Dutcho (indirect transfer of BraCo): no tax on Brazil

- Dividends distributed to the DutchCo by BraCo: No tax (domestic regulations).

- Allows planning for “**juros sobre capital propio**” if the Brazilian company is taxed under “**lucro real**”
Mexican investment through tax vehicle

- Mexican REFIPRES and ETVEs

  - Dividends distributed to LuxCo by ETVE and capital gains upon ETVE transfer: not taxed in Spain
  - Dividend income and capital gains derived from LatamCo and CyprusCo are exempt at the ETVE level
  - Dividends and gains from LatamCo are taxable in accordance with the provisions of the applicable tax treaty
  - Dividends distributed to the ETVE by CyprusCo should be covered by the EU Parent-Subsidiary and domestic Cyprus exemption; gains are only taxable in Spain (exempt)
  - Capital gains and dividends received by CyprusCo: not taxed under the CyprusCo’s participation exemption regime
  - Dividends distributed by IndianCo: taxable in India at a 17% tax rate. Tax planning available
  - Capital gains on transfer of shares of IndianCo: not taxed in India
V. Conclusions
Conclusions on the Spanish CFC regime

- Favorable CFC regime
- Applicable only to specific income items
- Compatible with participation exemption and tax exemption for branch profits
- Tax planning opportunities:
  - 85-15 rule; and *de minimis* exception
  - Branch rules; and EU subsidiaries
Q&A

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