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Spain's Holding Company Regime

This article describes the Spanish *entidad de tenencia de valores extranjeros* (holding company, ETVE) regime and considers the advantages and disadvantages of the ETVE regime for taxpayers.

1. Introduction

The *entidad de tenencia de valores extranjeros* (holding company, ETVE) regime is Spain's version of a special tax regime for holding companies.[1] It is designed to compete with similar tax regimes offered by countries such as Austria, Denmark, Luxembourg and the Netherlands. In some respects, the ETVE regime may have more advantages than the holding company regimes of these countries.

The purpose of this article is to provide a full description of the ETVE regime, as it may be attractive for international investors, especially following the reforms introduced by the new Spanish *Ley del Impuesto sobre Sociedades* (Corporate Income Tax Law, LIS), which has been in force since January 2015. As the authors indicate in this article, the new LIS introduces certain modifications both to the participation exemption and the ETVE regimes that: (1) clarify certain issues that were not fully clear in the previous version of the LIS; and (2) improve the regimes by eliminating some requirements, such as the business activity requirement.

The article first describes the special characteristics of an ETVE and next focuses on the tax treatment of dividends and capital gains derived by an ETVE. The article then moves on to deal with the tax treatment of dividends and capital gains derived by the shareholders of an ETVE.

2. Main Features of an ETVE

Although the ETVE regime is a special regime, any company subject to the corporate income tax in Spain may be granted ETVE status, subject to a few exceptions.[2] It is not necessary that the company applying for ETVE status be registered and formed in Spain. Consequently, a company formally set up abroad can be an ETVE, provided that its place of management is located in Spain.[3]

In order to qualify for ETVE status, a company must fulfil the following conditions:

- The corporate purpose of an ETVE must include the holding and management of shares of non-resident companies. However, an ETVE may be engaged in other activities that are not linked to the holding of foreign shares. This feature permits an ETVE to combine the ETVE regime with, for example, a permanent establishment (PE) abroad that undertakes other functions, such as financing, trading, etc. within a group of companies[4] with business activities in Spain, or with the holding of shares in Spanish companies.
- An ETVE's share capital must be represented by registered shares, i.e. bearer shares are not permitted.
- The management of the participations in foreign companies must be undertaken with "the organization of material and human resources"[5] of the ETVE. This is one of the more problematic requirements for an ETVE, as the absence of material and human resources may result in the ETVE falling under the special regime for "patrimonial companies" and all of the advantages of the ETVE regime would thereby be lost. Resolutions of the Spanish *Dirección General de Tributos* (General Directorate of Taxes, DGT) have contributed to clarifying this requirement. A DGT Resolution of 2002 is especially interesting in this regard.[6] Specifically, a company (company X) holding only one participation of 60% in the share capital of a Brazilian subsidiary, and, therefore, having minimal economic substance in terms of material and human resources, asked the DGT if company X could make use of the ETVE regime. Company X made it clear to the DGT that it was responsible only for the necessary meetings of its board of directors and that all of the administrative services, i.e. accounting, tax returns, etc., were

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1. The ETVE regime is governed by ES: *Ley del Impuesto sobre Sociedades* (Corporate Income Tax Law, LIS) arts. 107 and 108, Ley (Law) 27/2014 of 27 Nov.
2. The ETVE regime is not available to Spanish or European economic interest groupings, temporary unions of companies, in respect of which a special tax regime under the LIS applies, and to "patrimonial companies", i.e. companies which hold assets that are not used for business activities, as defined in the LIS.
3. *See* Resolutions of the DGT in ES: DGT, 6 June 2001, V0043-01 and ES: DGT, 4 Dec. 2003, 2069-03. DGT Resolutions are the DGT's written answers to questions asked by taxpayers regarding the interpretation of Spain's tax laws. The DGT's answer is binding on the tax administration in a tax audit of the taxpayer who asked the question. The answer is also binding on the tax administration in respect of other taxpayers if the facts and circumstances of their cases are identical (*see* ES: *Ley General Tributaria* (General Tax Law, LGT), art. 89).
4. Income from a foreign PE is exempt from tax in Spain if the conditions in the relevant legislation in respect of the exemption of income attributed to foreign PEs are satisfied or if a tax treaty applies that uses the exemption method to avoid double taxation.
5. All quotations of Spanish law and regulations are the authors' unofficial translations.
6. ES: DGT, 22 May 2002, 0778-02.

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provided by another company holding 50% of the capital of company X. The DGT answered that an ETVE must have the organization necessary to take the decisions for the correct management of the participation in a foreign subsidiary. In this context, the ETVE need not have the resources necessary to control the management of the foreign subsidiary, but, rather, only the material and human resources necessary to manage the participation and take all the decisions regarding the participation. According to the DGT, the requirement to have an organization of material and human resources is fulfilled if at least one member of the company's board of directors is in charge of the ETVE's ordinary management and, therefore, of the foreign participation. In addition, another DGT Resolution of 2004 concluded that, for these purposes, an ETVE need not necessarily have any personnel with labour contracts or premises.[7] However, an ETVE does not meet this requirement if the management and administration of the participation or the ETVE's administrative activities are all carried out with external staff and/or resources, or if the external staff and/or resources have all or some of the power to manage and administer the participation.

3. Access to the ETVE Regime

As noted in section 2., any Spanish company, whether or not newly established, which is subject to corporate income tax can have access to the ETVE regime, provided that its capital is not represented by bearer shares. For this purpose, a simple communication to the Spanish Ministry of Economy and Finance suffices. The ETVE regime then applies for the tax year ending after the communication and the subsequent tax years. The contents of the communication need not explain the factual or legal situation of the ETVE duties in Spain, regardless of the percentage of the ETVE's capital attributed to the shareholder making the contribution.

With regard to the ordinary management of an ETVE, the only special rule is that the ETVE must in its accounts state the amount of exempt income, i.e. dividends and capital gains, and the tax paid abroad. The ETVE must also provide its shareholders with all the information relevant to filing of their tax returns.

4. Taxation of an ETVE

4.1. Corporate taxation and ETVEs

For corporate income tax purposes, an ETVE does not have any special features compared to other Spanish companies. As with any other Spanish company, an ETVE is subject to corporate income tax in Spain and, therefore, has access to Spain's participation exemption, which applies to Spanish resident companies. The special characteristics of the ETVE regime relate to the taxation of an ETVE's shareholders and not to the taxation of its income.

7. ES: DGT, 31 Mar. 2004, 0898-04.

4.2. The participation exemption: Dividends from foreign companies

4.2.1. The basic rules

Dividends and other profit distributions received by an ETVE are exempt from Spanish corporate income tax if the conditions set out below are satisfied.

The Spanish LIS, in moving away from a credit system, has introduced a participation exemption regime, which also applies to ETVEs. Subject to certain conditions, dividends and income derived by a resident entity from the transfer of the participation in a foreign company are not subject to corporate income tax in Spain.

The main change introduced in 2015 consists in the removal of the business activity requirement.[8] However, it should be noted that, despite the removal of this requirement, the participation exemption should still not apply to income derived from the direct or indirect transfer of entities for which at least 15% of their income is subject to the Spanish controlled foreign company (CFC) rules.[9]

8. The previous LIS had as a requirement for the application of the participation exemption regime that non-resident entities from which the dividends were derived should carry out a business activity as defined in the LIS. This requirement is not included in the new LIS.
9. Provided that a CFC has the material and human resources necessary to carry out its activities, the new Spanish CFC legislation, i.e. art. 100 LIS, attributes to the CFC's Spanish shareholders only the following categories of income derived by the CFC: (1) income derived from immovable property or rights on immovable property, except when the property is used for a business activity or used by a foreign entity that belongs to the same commercial group as the CFC; (2) income derived from the participation in the capital of other entities and interest derived by the CFC, though important exceptions apply; (3) income derived from capitalization operations and insurance contracts where the entity is the beneficiary; (4) income derived from industrial and intellectual property, technical assistance, movable property, image rights and the lease or sublease of a business; (5) income derived from the alienation of any of the assets referred to in (1), (2), (3) and (4); (6) income derived from derivative instruments, unless used to hedge business activities; and (7) income derived from the provision of credit, financial, insurance or other services, unless directly connected to export activities, where the recipient of the services is an associated company resident in Spain and the payment for the services is a deductible expense for that company, though this does not apply if more than 50% of the CFC's income from credit, financial, insurance or other services is derived from transactions with non-associated companies. Where the CFC does not have the necessary material and human resources, all of its income should be attributed to its Spanish shareholder, unless another entity of the group provides these resources or it can be demonstrated that there are sound business reasons for the incorporation of the CFC. It should be noted that the income referred to in (2) and (5) is not subject to the CFC legislation where it is derived from companies in which the CFC, in which the Spanish shareholders have a participation, has a direct or indirect participation of at least 5% of the capital and: (i) the CFC holds and manages the participations in such companies with the relevant amount of organization of material and human resources; (ii) the participation is continuously held for at least one year; and (iii) at least 50% of the subsidiary's assets are used in business activities. Where the CFC derives less than 15% of its income from income referred to in (1) to (6), income should not be attributed to its Spanish shareholder. The income referred to in (7) should be attributed in full. It should be made clear that the participation exemption legislation refers to the types of income subject to the CFC rules, but, for the CFC legislation to apply, the foreign entity must not only derive the income referred to, but must also be controlled by a group of associated companies or persons having more than 50% of its capital, benefits or voting rights. The tax paid by the foreign entity on the types of income subject to the CFC rules must also be less than 75% of the tax payable in Spain on the same types of income.

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In addition, although dividends distributed by a foreign subsidiary to which the Spanish CFC rules apply should not be included in the Spanish parent company's taxable base in the moment of the distribution, such income would previously have been included in the Spanish parent company's taxable base as a result of the application of the CFC rules. Consequently, it should be concluded that the participation exemption should still not apply to income, i.e. both dividends and capital gains, derived from subsidiaries to which the Spanish CFC rules apply. In short, since 2015, the regime for ETVEs has been more of a special regime applicable to the non-resident partners of these companies than a specific corporate tax regime, as the general participation exemption regime should also apply to ETVEs.

The same can be said in relation to the deductibility of an ETVE's financial expense. This has been a frequent source of controversy with the Spanish tax administration, given that the deductibility of these expenses is subject to general limits and conditions. For these purposes, there is an objective limitation, which establishes that net financial expenses are deductible subject to a limit of 30% of the financial year's operating profit, with a minimum amount of EUR 1 million in any case (i.e. regardless of the company's operating profit, at least EUR 1 million would be deductible).

"Operating profit" is defined in a similar way to "earnings before interest tax depreciation and amortization" (EBITDA), even though it should be noted that financial income derived from participation in equity instruments is added to that result, provided that such income corresponds to dividends or a profit participation in respect of entities in which either the participation percentage, direct or indirect, is at least 5% or the value of the purchase of the participation is greater than EUR 20 million. Such financial income would normally be exempt, but it is considered in determining a company's operating profit for the purposes of the deduction of financial expenses. Consequently, dividends and capital gains derived from qualifying foreign subsidiaries increase the amount of deductible financial expenses without increasing the Spanish entity's taxable base.

Another limitation is that established in relation to financial expenses derived from debt from group entities used in the acquisition, with regard to other group entities, of entities or used to make equity contributions. In such circumstances, the financial expenses are not deductible, unless the company can demonstrate that there were sound business reasons for carrying out the transactions.

This provision originates from the text set out in Royal Decree 12/2012.[10] The Statement of Purpose in respect of this Royal Decree establishes that the following circumstances may be considered sound business reasons:

– the internal transfer of the participation is a direct consequence of an acquisition from third parties, in which case it could be understood that the financing was not intended for a group company, but, rather, for other individuals or entities unrelated to the company and what is now being undertaken is a restructuring within the group; and
– there is real management of affiliated companies acquired in the Spanish territory.

There is also a limit that applies in respect of leveraged buyouts, which is intended to avoid an increase in the basis to which the 30% limit applies, i.e. the operating profit of the purchasing company, as a result of corporate transactions. The relevant circumstances of this limit are as follows:

– financial expenses derived from debt used in the acquisition of any type of entity should be deducted with an additional limit of 30% of the operating profit of the entity that made the purchase, without considering the operating profit of any entity merged with it during the four-year period following the purchase; and
– financial expenses derived from debt used for the acquisition of any type of entity that is incorporated into a tax group should be subject to the additional limit of 30% of the operating profit of the purchasing entity or tax group, without considering the operating profit of the purchased entity or of any other entity incorporated into the tax group in the tax years beginning during the four-year period following the acquisition.

4.2.2. Participation threshold in the foreign subsidiary

As stated in section 4.1., the participation exemption regime for ETVEs is the general one. The regime requires that the direct or indirect participation in the capital or equity of the entity is at least 5% or that the participation acquisition cost is greater than EUR 20 million.

The corresponding participation must be held continuously during the year prior to the date on which the dividends become payable, i.e. the one-year qualification period can be completed after the dividend distribution. In determining this period, the holding period of any other entity in the group should also be considered.

There is no limitation regarding the percentage of the subsidiary's indirect participation. If the exemption is applied on the basis of its value, the authors understand that the wording of the law, i.e. regarding the purchase value of the participation, requires that the amount of the investment should refer to a direct participation.

There are no conditions with regard to the nature of the activities of the subsidiary, except for cases in which the subsidiary company is, in turn, a holding or portfolio entity. If the subsidiary derives dividends, profit participation or income deriving from the transfer of securities representing the capital or equity of other entities in an amount greater than 70% of its income, the application of the exemption with regard to this income should require that the ETVE has an indirect participation in those entities, which, in turn, fulfil the requirements of participation percentage or acquisition value and continuity. This

10. ES: *Reales Decretos* (Royal Decree) 12/2012.

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provision is intended to limit the application of the exemption to indirect participation derived by vehicles in which the participation of various investors are grouped, even though the introduction of the purchase value parameter in the exemption reduces its effects.

In addition, if the subsidiary holds indirect participations in other entities, that participation in second, or lower, tier subsidiaries should be subject to the minimum 5% requirement, unless these subsidiaries are part of the same group of companies as the direct subsidiary. This requirement does not apply if the dividends have already been taxed at the level of the subsidiary and if, additionally, the dividends do not have the right to participation exemption or double tax credit. Where the indirect participation requirement is only met with regard to certain companies, the exemption applies to that portion of the dividends received from companies in which these requirements have been fulfilled.

An ETVE should also, normally, be a company to which the EU Parent-Subsidiary Directive (2011/96)[11] applies. This applies inasmuch as it is a company resident in Spain that assumes one of the recognized legal forms and is subject to and not exempt from corporate income tax, independent of its actual taxation when applying an exemption for double taxation.

4.2.3. *Minimum corporate income tax rate for the investee company*

A new feature for the capital participation of non-resident entities in Spanish territory is the introduction of a requirement that the subsidiary must be subject to and not exempt from a tax of an identical or analogous nature to the Spanish corporate income tax at a nominal rate of at least 10%. This applies notwithstanding that, by applying any type of exemption, discount or credit, the effective tax rate could be lower.[12]

This minimum taxation is required in the financial year in which the profits being distributed were obtained. If the subsidiary has only met the requirement in certain financial years, it will be necessary to identify in which financial year the profits were generated. In other words:
- in respect of the distribution of reserves, the designation contained in the corporate resolution should be used; and
- in the absence of such a resolution, the most recent amounts added to those reserves should be considered to be those distributed.

With regard to the nature of the tax to which the foreign subsidiary must be subject, those taxes whose purpose was the taxation of the income obtained must be taken into account, regardless of its object being the income, the revenue or any other element indicative thereof.

Finally, it should be noted that, despite the inclusion of the minimum 10% threshold, article 21 of the LIS still establishes a *iures et de iure* presumption. This requirement is met if: (1) the subsidiary is resident in a treaty jurisdiction; (2) that tax treaty has an exchange of information clause; and (3) the tax treaty applies to the subsidiary. As a result, provided that these three requirements are met, it should not be necessary to verify if the subsidiary is subject to tax in the terms explained previously in this section.

4.2.4. *Tax havens and the comparable tax requirement*

If the subsidiary is located in a tax haven that is on Spain's blacklist,[13] even if the subsidiary is subject to a corporate income tax at a rate higher than the rate in Spain, the dividends derived from the subsidiary cannot benefit from Spanish participation exemption. The Spanish regulations on tax havens permit a country to be removed from the blacklist if that country concludes a tax treaty that includes an exchange-of-information clause or concludes an exchange-of-information agreement with Spain.

In this context, it should be noted that, since 2015, the law has also envisaged that the list of tax havens will be updated by Royal Decree, taking into account circumstances, such as that there is no effective exchange of tax information under the terms or the results of the peer review evaluations as undertaken by the *Foro Global de Transparencia e Intercambio de Información con Fines Fiscales* (Global Forum on Transparency and Exchange of Information for Tax Purposes).

4.3. Capital gains derived by an ETVE from the transfer of a participation in a foreign company

Capital gains derived by an ETVE from the alienation of a participation in a foreign company are exempt from Spanish corporate income tax, provided that the participation held by the company meets the requirements for the exemption of dividends (*see* section 4.2.). These requirements must be fulfilled at the time of the transfer, for which purpose:
- the one-year ownership period that is required for applying the exemption cannot be completed subsequently;

11. Council Directive 2011/96/EU of 30 November 2011 on the Common System of Taxation Applicable in the case of Parent Companies and Subsidiaries of Different Member States, OJ C 107 (2011), EU Law IBFD.
12. The inclusion of the 10% minimum threshold removes the uncertainty that existed in the previous LIS. The DGT has issued several Resolutions analysing this issue, e.g. ES: DGT, 16 Sept. 2003, 1327-03, in which it was concluded that a 5% corporate income tax rate applying to a PE in Guatemala should be considered to be equivalent and analogous to the Spanish corporate income tax, but no general guidance can be obtained from these Resolutions.
13. Currently, the following jurisdictions are considered to be tax havens for Spanish purposes: Anguilla, Antigua and Barbuda, Bahrain, Bermuda, the British Virgin Islands, Brunei, the Cayman Islands, the Cook Islands, Dominica, Fiji, Gibraltar, Granada, Guernsey, the Isle of Man, Jersey, Jordan, Lebanon, Liberia, Liechtenstein, Macau, the Malvinas (the Falkland Islands), the Mariana Islands, Mauritius, Monaco, Montserrat, Nauru, St. Lucia, St. Vincent and the Grenadines, the Seychelles, the Solomon Islands, the Turks and Caicos Islands, Vanuatu and the US Virgin Islands. In the authors' opinion, it should be concluded that the countries or territories classified as tax havens which apply the EU directives on exchange of information should not be considered to be tax havens from the Spanish perspective, and the participation exemption should, therefore, apply if the subject-to-tax requirement is met. This should be the case for Gibraltar. It is quite likely, however, that the Spanish tax administration would not accept such a conclusion.

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- where the participation in foreign entities is under consideration, the investee entity must have been subject to, and not exempt from, a foreign tax of an identical or analogous nature to the corporate income tax at a nominal rate of at least 10% for all the years of the participation's ownership. Where there is fulfilment in only one of the financial years in which there was ownership of the participation, the exemption only partially applies, as it is necessary to distinguish that part of the income that corresponds to an increase in undistributed profits generated by the investee company during the time period of the participation ownership, i.e. the exemption applying to those financial years in which the requirement has been fulfilled, from the remainder, which is understood as having been derived in a linear fashion, for which reason it should be exempt in the proportion that that part bears to the financial years of reference;
- in the case of the participation's transfer of an entity which, in turn, is to participate in two or more entities with regard to which only in one or some of them the minimum taxation under corporate income tax is met, the foregoing calculation should be used in applying the exemption to the increase in profits or remainder that originates from entities which meet the taxation requirement.

4.4. Anti-abuse clause and limitations

There is an anti-abuse clause, which also generally applies, in the LIS. The exemption does not apply with regard to the amount of those dividends whose distribution gives rise to a tax-deductible expense for the paying entity.

The LIS also sets certain limitations regarding the application of the participation exemption. Briefly, these limitations are:

- If the participation in the subsidiary was previously transferred by another entity that forms part of the same group of companies, as defined by the Spanish *Código de Comercio* (Commercial Code, CCo), the gain derived from the alienation of the participation is taxable for the ETVE to the extent that a loss was included in the corporate income tax base of the related company. Similarly, where an ETVE includes a loss in its corporate tax base and the participation was acquired by the ETVE from a company in the same group of companies, the loss is reduced by an amount equal to the gain derived from the preceding transfer and exempt from tax in Spain. Both rules are intended to limit the inclusion of artificial losses in the tax base of an ETVE or another company in the same group.
- Where the participation in the foreign subsidiary was acquired under the special regime in Spain that implements the Merger Directive (2009/133)[14] and, as a result, the capital gains relating to a participation or an asset that does not permit the use of the participation exemption are excluded from the corporate income tax base, the capital gains derived by the ETVE are divided into two parts. The part relating to the asset or participation transferred that does not benefit from the participation exemption is taxable and the part relating to the increase in value of the participation that may benefit from the participation exemption while it was held by the ETVE is exempt.
- Losses derived from the transfer of the subsidiary must be reduced by the amount of exempt dividends received since 2009.
- In the case of successive transfers of homogeneous shares, the amount of losses must be additionally reduced by the amount of positive exempt income derived from previous transfers.

5. Dividends and Capital Gains Received by the Shareholders of an ETVE[15]

5.1. Introductory remarks

A special feature of the ETVE regime relates to the tax treatment of the dividends and capital gains received by the shareholders of an ETVE. As discussed in section 4.1., with regard to the dividends received by an ETVE from its subsidiaries and the capital gains derived from the alienation of participations in them, the ETVE is treated as any other Spanish company that has access to the participation exemption. However, the situation is different regarding the tax treatment of the dividends distributed by an ETVE and the capital gains derived from the alienation of participations in the ETVE.

In general, unless a tax treaty or the Parent-Subsidiary Directive (2011/96) applies, dividends and capital gains derived by a non-resident shareholder from its participation in a Spanish entity are subject to taxation in Spain at a rate of 19%. However, a special tax treatment applies under the ETVE legislation.

In sections 5.2. to 5.6., the authors comment on the main characteristics of this special tax treatment.

5.2. Taxation of dividends received by non-resident shareholders from an ETVE

The dividends received by an ETVE's non-resident shareholders that do not have a PE in Spain are not subject to tax in Spain if the dividends relate to foreign participations qualifying for the participation exemption.[16] This is because the relevant legislation presumes that the dividends flow through the ETVE and, as the income derived

14. Council Directive 2009/133/EC of 19 October 2009 on the Common System of Taxation Applicable to Mergers, Divisions, Partial Divisions, Transfers of Assets and Exchanges of Shares concerning Companies of Different Member States and to the Transfer of the Registered Office of an SE Or SCE between Member States OJ L 310 (2009), EU Law IBFD.
15. This discussion basically refers to the tax treatment of shareholders who are non-residents of Spain as this may be more interesting from an international perspective.
16. If the dividends are distributed to a Spanish company or a PE in Spain of a non-resident company, the general regime applies. In the case of Spanish resident individuals, dividend received from an ETVE are deemed to be savings income.

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by the subsidiary has no connection with Spain, it is not taxable. Another presumption is that the first dividends distributed to the shareholders are derived from the ETVE's exempt income. Similarly, share premium distribution must be subject to the same tax treatment as dividend distributions. The new LIS also establishes that the exemption applies to dividends distributed by an ETVE to its non-resident shareholders if these dividends relate to income derived by the ETVE from a PE located outside Spain to which the exemption applies.[17]

5.3. Taxation of capital gains derived by non-resident shareholders from an ETVE

A special tax treatment applies to the capital gains derived by a non-resident shareholder without a PE in Spain from the alienation of a participation in an ETVE, from the separation of the shareholder and from the liquidation of the ETVE. Specifically, non-resident shareholders are not taxable in Spain on the capital gains that correspond to the ETVE's reserves created with the ETVE's exempt dividends or to the differences in value of the participation in the ETVE attributable to the differences in value of the ETVE's participation in foreign subsidiaries that qualify for the participation exemption regime. In this respect, it should be noted that, if the ETVE's shareholder has access to a tax treaty concluded by Spain that follows article 13 of the OECD Model,[18] all the capital gains are exempt from tax in Spain.

5.4. Application of the exemption to double-tier ETVEs

A literal interpretation of the LIS would not permit the application of the exemption to dividends distributed by the top-tier ETVE to its non-resident shareholders, as these dividends would be deemed to be Spanish source. However, such a literal interpretation would imply a limitation that, in the authors' opinion, would be contrary to the purpose of the ETVE regime, this purpose being the non-taxation in Spain of income derived from qualified non-resident subsidiaries. As this is the purpose of the ETVE regime, in the authors' view, the dividends distributed by the top-tier ETVE should also be exempt from taxation in Spain, provided that the non-resident shareholder meets the requirements for the application of the ETVE regime. This interpretation has also been adopted by the DGT in several of its Resolutions, most recently in the Resolution of 2016.[19]

5.5. Determination of the exempt income

Determining the exempt income of partners when an ETVE's only assets are qualifying foreign subsidiaries is not a problem, as the total amount of dividends distributed or capital gains would be exempt from taxation in Spain if derived by non-resident shareholders. On the other hand, in cases in which an ETVE derives both exempt and taxable income, determining the exempt dividend or capital gains derived by its non-resident shareholders is not so easy.

A literal interpretation of the LIS could make it possible to conclude that the amount of the exempt dividend should be equal to the dividends or capital gains obtained by the ETVE from qualifying non-resident subsidiaries. However, if the purpose of the ETVE regime, i.e. excluding from taxation income derived by non-resident shareholders from their participation in the ETVE, as long as this income derives from qualifying non-resident subsidiaries, is taken into account, it should be concluded that, despite the wording of the LIS, the exemption should apply, not to gross, but to net income.

Consequently, in order to determine the exempt income derived by a non-resident shareholder of an ETVE, the exempt income derived by the ETVE should be reduced by the following two amounts: (1) the expenses directly incurred in obtaining the income; and (2) that part of the indirect expenses that can be allocated to the activity consisting in holding qualifying non-resident subsidiaries.

5.6. Limitations on the application of the ETVE regime where the income recipient is resident in a tax haven

Dividends distributed by an ETVE and capital gains derived by its shareholders from the transfer of their investment in the ETVE are not exempt from tax in Spain if the income recipient is a resident of a tax haven, i.e. a jurisdiction or territory on Spain's blacklist. Tax havens are, however, not entirely precluded from the ETVE regime as:

- the black list of tax havens is old and incomplete, and not all of the territories that can be regarded as tax havens are on the list. This means that entities or individuals from tax havens not on the blacklist can have access to the ETVE regime;
- the wording of article 108(4) of the LIS is ambiguous in that it provides that dividends are subject to tax in Spain if the "recipient" is a resident of a tax haven. The meaning of the term "recipient" is far from clear. The term could be interpreted as including a "recipient" who is a fiduciary entity or nominee that is not resident in a tax haven and acts as the income recipient, even though the income is in the name of a resident of a tax haven, in which case the dividends are received free of Spanish withholding tax.

The DGT Resolution of 2001 made it clear that the term "recipient" means "the legitimate owner of the property or rights from which the income is derived".[20] Consequently,

17. The previous LIS did not refer to the application of the exemption to dividends distributed to non-resident shareholders from income derived by an ETVE through a PE. In this context, it should be noted that the DGT had issued resolutions both accepting the application of the exemption and rejecting it, i.e. ES: DGT, 8 Oct. 2009, V2261-09 and ES: DGT, 13 Oct. 1997, V0007-97. Consequently, the new LIS has clarified this issue in a positive way.
18. *OECD Model Tax Convention on Income and on Capital* (26 July 2014), Models IBFD.
19. ES: DGT, 15 Feb. 2016, V0601-16.
20. ES: DGT, 26 Dec. 2001, 2306-01.

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it would appear that the term "recipient" means the "beneficial owner" of the dividends, even though the DGT did not use this term. However, the DGT's clarification may not be completely satisfactory, as, in some countries an entity may have shares in trust without revealing the fiduciary relationship with another entity or individual, in respect of which the relationship cannot be known to the tax administration. In these cases, in the authors' opinion, the dividends distributed by an ETVE should be subject to tax in Spain, but the wording of the law and the DGT's clarification are not sufficiently clear in this respect.

It should be noted that it is possible to have access to the ETVE regime using hybrid entities, which are located in a tax haven or which can take advantage of a regime offering a low or zero rate of tax and which are regarded as transparent from the Spanish perspective, but are not considered as such from the perspective of the beneficial owner's residence state. In some of these cases, the DGT has determined that the "dividend recipient" was the legitimate owner and not the hybrid entity.[21] However, in these Resolutions, the DGT considers that, in order to conclude that a non-resident entity should be considered as transparent for these purposes, it should be identical in nature to Spanish *entidades en atribución de rentas* (transparent entities, EARs).[22] In these circumstances, the DGT has concluded that, in order to apply the ETVE exemption to dividends derived by non-residents from an ETVE, instead of considering the tax residence status of the transparent entity, the residence of the partner of the EAR should be considered.

Special reference should be made to the situation of a US entity or individual investing in an ETVE through a partnership or disregarded entity organized in a tax haven for Spanish tax purposes. Based on the Spain-United States Mutual Agreement to the 1990 Treaty (2006),[23] the authors' view is that, in this particular case, even if the result of the analysis is that, from the Spanish perspective, the entity's characteristics are not those of a Spanish EAR, but rather that, from the US perspective, it is a partnership or disregarded entity, the ETVE regime should apply to both dividends distributed by the ETVE and capital gains derived from the ETVE by its ultimate US shareholders.[24]

21. *See* ES: DGT, 26 Dec. 2001, 2306-01; ES: DGT, 22 Apr. 2003, V0037-03; ES: DGT, 13 Nov. 2015, V3505-15; and ES: DGT, 15 Feb. 2016, 0601-16.
22. Briefly, Spanish EARs are entities without legal personality that are distinct from their partners. They have a general partner with unlimited responsibility, and they attribute their profits to their partners.
23. As established in the *Competent Authority Mutual Agreement* (30 Jan. 2006), Treaties IBFD, art. 1, second sentence of the *Spain-US Mutual Agreement* (2006) states that "income received by an LLC, or other entity, whether organized within or without the United States, that is treated for U.S. federal tax purposes as a partnership or disregarded as an entity separate from its owner, will be treated as income derived by a resident of the United States to the extent that income received by the LLC or other entity is subject to U.S. tax as the income of a U.S. resident".
24. It should be noted that this only applies to the dividends attributable to the US shareholder. Where the direct shareholder has other shareholders located outside the United States, a general analysis must be undertaken to apply the exemption.

6. ETVE Access to the Spanish Treaty Network

As stated in section 4.1., despite the fact that qualifying dividends and capital gains derived by an ETVE are exempt from taxation in Spain, the ETVE is subject to tax in Spain. Consequently, the ETVE should be eligible for treaty benefits.[25,26]

Notwithstanding this, there is a certain degree of controversy in this regard, as not all of the states that have concluded a tax treaty with Spain share this interpretation. This is so in respect of Brazil, which includes the ETVEs in their grey list in 2002, thereby denying the application of the exemption in article 23(4) of the Spain-Brazil Income Tax Treaty (1974)[27] to dividends distributed by an ETVE to its Brazilian shareholders. However, the inclusion of the ETVE in the Brazilian grey list has been suspended since 2010. This suspension may be terminated at any time, either to reinstate the regime, which is what happened in the case of the Netherlands in December 2015, or to remove it definitively, which is what happened in the case of Luxembourg in 2011 and Hungary in 2014.

It should be noted that some of the tax treaties concluded by Spain, i.e. those concluded with Estonia, Iceland, Ireland, Israel, Latvia, Lithuania, Malaysia, Russia, Slovenia and South Africa, exclude the application of the treaty benefits with regard to dividends, interest, royalties and capital gains paid to pure holding entities where more than 50% of the shareholders are not tax resident in either of the contracting states. As a result, in such cases, an ETVE might not have access to these benefits.

7. Conclusions

The ETVE regime is similar to and perhaps more favourable than the holding company regimes of other, more traditional, jurisdictions. Apart from the specific benefits of Spain's participation exemption, if used correctly, an ETVE can be combined with other provisions or structures to reduce the total tax burden of a group of companies.

One of the advantages of the ETVE is that it can be combined with other structures, such as foreign sub-holding companies or foreign tax regimes that offer worldwide consolidation. An ETVE can also be used with PEs located in other countries, i.e. financial or trading branches, whereby the amounts paid out of the income of PEs are also exempt for the ETVE's shareholders. Similarly, increases in

25. As established in art. 1 *OECD Model* (2014), tax treaties apply "to persons who are residents of one or both of the Contracting States". In addition, according to art. 3 *OECD Model* (2014), "the term "person" includes an individual, a company and any other body of persons" and according to art. 4, "the term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature".
26. This is also the criterion established in ES: DGT, 14 July 2003, 0979-03.
27. *Convention between the Spanish State and the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (14 Nov. 1974), Treaties IBFD.

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value of the participations of shareholders in ETVEs that correspond to the PE are exempt from Spanish taxation.

Another advantage is that, contrary to the rules in other jurisdictions, the participation exemption at the level of the ETVE applies to the dividends paid out of the foreign subsidiary's passive income, i.e. royalties and income from certain financial activities or image rights. This is provided that such income does not fall within Spain's CFC regime. Finally, dividends and capital gains derived from qualifying foreign subsidiaries increase the amount of the deductible financial expenses without increasing the Spanish entity's taxable base.

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