SPANISH HOLDING COMPANY STRUCTURES: ETVE (ENTIDADES DE TENENCIA DE VALORES EXTRANJEROS)

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1. Introduction

Entidades de Tenencia de Valores Extranjeros or its acronym 'ETVE' is the name given by the Spanish Corporate Income (CIT) Tax approved by Royal Decree Law 4/2004 to Spanish holding companies. Article 116 of ETVE provides that a regular Spanish company is subject to regular corporate tax on its income, but fully exempt from taxation on qualified foreign source dividends and capital gains. This kind of regime was introduced first in 1995 as a platform for investments into Latin America through Spain as well as an exit route for EU capital investment based on the Spanish Tax Treaties.

At the present time, Spain has signed 94 tax treaties to avoid double taxation, 9 of which (Azerbaijan, Kuwait, Namibia, Nigeria, Oman, Peru, Dominican Republic, Senegal and Syria) are in different processing phases. Although ETVEs are sometimes considered a different kind of company, we must take into account that, as we have seen, the ETVE is only a regime that any Spanish company -limited liability companies (Sociedad Limitada, S.L.) or company limited by shares (Sociedad Anónima, S.A.) - can accede if they meet certain requirements. Moreover, this regime has been excluded from the Harmful Tax Practices by the Primarolo Group in the "Code of Conduct" and inside the legal framework composed by the internal legislation, the European Union Directives (Parent/Subsidiary Directive and Merger Directive) and the tax treaties signed by Spain.

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2. Requirements of the ETVEs

The requirements that a company has to meet in order to be accepted in the ETVE regime and, as a consequence, that dividends and capital gains received by the company from non-resident subsidiaries will be exempt from Spanish taxation are set-out in Articles 116[2] and 21[3] of the CIT Law, as follows:

- The business purpose of the Spanish company will include, among others, the management and control of participations in operating non-resident entities.
- The ETVE will carry on its activities with the necessary human and material resources.
- The shares or quotas of the company will be in registered form. Pursuant to a recent ruling of the Spanish Tax Authorities, Spanish listed companies may opt for the regime.
- The Spanish holding company will inform the Spanish Tax Authority (Agencia Tributaria or the "AEAT") that it opts to be subject to the provisions of the ETVE regime
- The company will hold a minimum 5% participation in the equity of the non-resident subsidiary (and any second-tier subsidiary) or, alternatively, the acquisition value of the interest in the non-resident subsidiary amounts to €6 million (EURO)
- The company directly or indirectly will hold the interest in the non-resident subsidiary (and any second level subsidiary) for at least one year
- The non-resident subsidiary will be subject to and not exempt from a tax similar in nature to the Spanish C.I.T. and will not be resident in a tax haven country or jurisdiction
- The non-resident subsidiary will be engaged in an active trade or business

2 Article 116 contains the requirements that a company has to meet in order to be accepted in the ETVE regime (the first four requirements) and article 21 contains the requirements that a company has to meet in order to be exempt from Spanish taxation for the dividends and capital gains received by the company from non-resident subsidiaries.

3 Article 21 was amended by Law 4/2008, December 23 and Royal Decree Law 12/2012, March 30. The last of the amend establishes the application of a rule of proportionality of the exemption based on the period of time in which the requirements are met for application compared with the total holding period.

And the Party "IU" has asked the Spanish parliament to replace the exemption in Article 21 of that Act for a deduction that would eliminate international double taxation on dividends and foreign income arising from the transfer of securities representing the equity of entities not resident in Spanish territory, so that Spain can tax in its territory on the part of the income not been taxed according to the tax rates prevailing in the Spanish rules.

Business Purpose

Although as we have seen before, the business purpose of the Spanish holding company must include the management and control of participations in operating non-resident entities, the company is allowed to do other activities. These other activities will be subject to general CIT and the dividends distributed on such profits will be subject to regular Spanish withholding tax.

Substance

There has been some controversy about the way to meet the proper human and material resources requirement imposed on the companies. The main doubts were focused in two questions:

- Was it possible to outsource the service of management and control and meet the requirement?
- Was necessary for the company to control and manage the activities of the participated companies or just to control and manage its participation?

The Spanish General Tax Directorate (Dirección General de Tributos or the "DGT"), the administrative body in charge of drafting and interpreting tax legislation, has clarified this essential requirement for ETVE in two non-binding rulings dated May 22, 2002, and December 20, 2002, and one binding ruling issued on October 29, 2003[4]

The D.G.T. takes the view that the proper human and material resources requirement is met, if:

1) The day-to-day management of the company is vested in one or more directors of the company empowered with sufficiently broad powers of attorney to allow him/her to manage the company, provided that such director is *resident in Spain for tax purposes*. Day-to-day activities include the performance of accounting, tax and legal obligations required for the fulfilment of the corporate purpose of the company. Conversely, the DGT has expressly stated that if those services are completely outsourced, it will be deemed that the company does not fulfil the "human and material resources" requirement; and

2) It is not necessary for the company to control and manage the activities of the participated companies. All that is required is the control and management of the participation.

4 We must note that both DGT rulings are framed within the context of the E.U. Code of Conduct and the attempt by the Ecofin Council to eliminate harmful tax competition within the E.U.

Filings

The company must notify the Spanish Tax Authorities of its intention to apply the holding company tax regime and inform the Spanish Tax Authority that it opts to be subject to the provisions of the ETVE regime. The special tax regime will come into effect in the tax period that ends after the notice is filed.

Residence requirements

The subsidiaries must be non-Spanish resident entities and must not be resident in a tax haven jurisdiction.

Minimum participation and holding period

The equity of the non-resident subsidiary may be represented by shares, quotas or other forms of capital interest. The company must hold a minimum 5% participation in the equity of the non-resident subsidiary (and any second-tier subsidiary) or, alternatively, the acquisition value of the interest in the first tier non-resident subsidiary must amount to €6 million Euro) and lower tier subsidiaries.

Dividends will be exempt at the level of the ETVE even if the required one year holding period is completed after the dividends have been received. By comparison, capital gains are exempt only if the one year holding period requirement is met on the date when the transfer takes place.

For the purposes of computing the time during which the participation has been held by the ETVE, foreign participations will be considered to have been held by a newly incorporated ETVE from the date on which they were held by other companies within the same consolidated group for accounting purposes.

Similar nature

The non-resident subsidiary must be subject to and not exempt from a tax of a nature similar to the Spanish CIT. To determine the degree of compatibility of foreign tax systems with the Spanish CIT quite difficult and will have to be tested. However, this requirement will be deemed to be met if the non-resident subsidiary resides in a tax treaty country provided that the treaty contains an exchange of information clause[5].

5 It should be noted that all treaties entered into by Spain contain exchange of information clauses. There are a couple of interesting binding rulings from the Spanish General Tax Directorate dated December 3, 2004, and March 17, 2005. In both cases the companies were in a tax holiday situation but, in the first case, there was no similar tax and that was why it did not met the ETVE requirements.

As established in other countries, this requirement will never be met if non-resident subsidiaries are located in one of the tax haven countries or territories established by Royal Decree 1080/1991 and will not qualify for the ETVE tax.

Activity

The non-resident subsidiary must carry out active trade or business outside Spain. At least 85% of the income earned by the non-resident subsidiaries must be derived from business activities conducted outside Spain (15% of certain passive income may be generated, with certain limits).

3. Taxation

Inbound dividend

Dividends obtained from "qualified non-resident subsidiaries" and (ii) capital gains realized on the transfer of the shares held by ETVE in qualified non-resident subsidiaries are exempt from Spanish Corporate Income Tax (CIT).

Outbound dividend

Dividends distributed by the company to its foreign shareholders are not subject to Spanish withholding tax, as long as:

- The dividends are distributed out of exempt dividends or capital gains obtained by the ETVE from qualifying subsidiaries (D/CG that were exempt from tax at the level of the ETVE)
- Dividends are paid to an individual or to an entity not resident in Spain
- The direct recipient of the dividend is not a resident of a tax haven jurisdiction
- In any case, no withholding tax if the Parent/Subsidiary Directive is applied.

Capital gains on transfer of ETVE

Capital gains triggered by the non-resident ETVE shareholders, other than a tax haven company, on the transfer or full amortization of its interest in the ETVE and liquidation of the ETVEs, will not be subject to Spanish Capital Gains tax to the extent that the capital gain is equivalent to:

a) the existing reserves (from qualified exempt income) of the ETVE and/or

b) a difference in value of the interest in the foreign subsidiaries of the ETVE, if such interest, fulfils some requirements.

Deduction of goodwill on foreign subsidiaries

The difference between the acquisition cost of shares and underlying book value of foreign subsidiary is attributed to the assets of the foreign subsidiary in accordance with the Spanish accounting valuation rules governing consolidated financial (i.e., limited to the market value of the assets). Any difference not allocated to the step-up of the assets of the target is deductible over 20 years (with a maximum of 5% per year). The ETVE may be used to offset taxable profits of the ETVE (i.e. those profits not linked to its participation in foreign subsidiaries)

Compared with other EU holdings

Compared with others EU Holdings

	NL	LUX	ETVE
Exemption of inbound dividends and capital gains (participation exemption regime)	✓	✓	✓
Capital losses deductible	X	✓	✓
Provision for portfolio depreciation deductible	X	X	✓
Financial costs deductible	✓	X	✓
Fiscal consolidation	✓	✓	✓
Transfer of holding company not taxed	✓	✓	✓
No withholding tax of outbound dividends distributed by holding company (Lux, in some cases: tax treaty, 10%/1,2€ M…) (NL "cooperative")	✓	X	✓
No taxation of contributions	✓	✓	✓
Stable and reliable system	✓	✓	✓

4. Assessment of the ETVE regime

The ETVE tax regime is fully comparable with the participation exemption or holding company status offered by other jurisdictions, and can be even more advantageous in some cases. Therefore, the ETVE should be taken into account by those considering transnational investments in foreign subsidiaries as an excellent tax planning vehicle. The Spanish ETVE is a resident company for the purpose of Double Tax Treaties signed by Spain, which basically means that it can benefit from the provisions of such norms (some limitations may apply if the Double Tax Treaty contains a limitation on benefits provision, which, although not usual in Spanish Double Tax Treaties, may be found in some of them: e.g. Portugal, Ireland, US).

Spain has, as we have seen before, an increasingly important Double Tax Treaty network featuring 94 Double Tax Conventions with almost all European countries, some of them with Latin American countries such as e.g. Argentina, Brazil, Bolivia, Ecuador, or Asian States such as China, Korea, Philippines, India, Indonesia or Thailand. The Spanish Treaty Network is expanding rapidly and is expected to grow in the coming years. Additionally, the Spanish ETVE may take advantage of the Parent-Subsidiary Directive: 0 % withholding tax for dividends received from subsidiaries resident in other European Union countries (if the conditions for the application of such a norm are complied with). Moreover, the ETVE is exempt from Stamp Duty (1 per cent) payable on the issue of shares if the subscription price for the ETVE shares is paid in kind, for example, when the shareholders of an ETVE exchange assets (e.g. shares in foreign companies) they own for shares of the ETVE (provided the shares in the non-resident companies comply with the requirements, mentioned above, for the benefit or capital gains exemption in the hands of the ETVE to be applied).

5. Conclusions

Seventeen years since the ETVE regime was introduced in Spain, the combination of an attractive tax legislation for foreign investment and economic stability has made the ETVE a regime to consider internationally. Its vocation to prioritize investment in business activities developed in countries with similar tax regimes have help the Spanish ETVE not to be marked, unlike other countries holding companies, as a harmful tax measure by the Group in Charge of Implementing the European Union Code of Conduct on Business Taxation.

Regarding the practical effects of the regime itself, the possibility that dividends distributed by the company to its foreign shareholders are not subject to Spanish withholding tax and that Capital gains triggered by the non-resident ETVE shareholders on the transfer or full amortization of its interest in the ETVE and liquidation of the ETVE will not be subject to Spanish Capital Gain tax has led to a large number of multinationals (American and European) using the ETVE as an efficient platform for investments in Latin America.

In summary, the ETVE regime is an attractive regime that must be used with proper tax planning in order to ensure there are no unwanted outcomes.