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Spain's approval to amend double tax treaties

Legal flash

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After its deposit with the OECD on late September, Spain completes internal procedures for ratifying the instrument that modifies double tax treaties

- The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("Multilateral Instrument" or "MLI") is an international convention aimed at amending double tax treaties to introduce the main measures of the OECD's BEPS Plan.
- Although Spain signed the convention over three years ago, it did not give its official approval until today with publication in the Official Gazette of the Spanish State ("BOE").
- The MLI will be in force for Spain on January 1, 2022. However, it will be necessary to analyze each double tax treaty individually and exhaustively to assess the impact of these amendments, as the MLI could affect each one differently.

Multilateral Instrument is approved

The MLI was agreed under Action 15 of the OECD's BEPS Plan as a mechanism for implementing some of the plan's measures in an agile and dynamic way in double tax treaties ("DTTs").

The MLI is unique: it is a multilateral convention (i.e., signed by many states) whose purpose it is to introduce amendments in DTTs, which are bilateral treaties. The signing states take their position regarding the MLI by choosing from the options the MLI offers; this is extremely important, as a provision of a DTT will only be amended when two contracting states have the same position in relation to the amendment by the MLI of that provision.

Although the MLI was signed in Paris on June 7, 2017, after that, the signatory states had to complete the relevant internal procedures, so that the MLI could come into force for each state. As Spain signed the MLI *ad referendum*, the Spanish parliament's approval was required. These procedures, including the deposit with the OECD and the publication in the Official Gazette of the Spanish State, have now been completed (available *here*).

The MLI will be in force in Spain on January 1, 2022, as it has been in some states already. The OECD, as depositary, carries out a follow-up that can be consulted at this *link*.

A different matter is the effective date of the MLI, i.e., when it actually amends the content of a particular DTT. As indicated, it is not enough for the MLI to have entered into force for one of the contracting states of the particular DTT; it must be in force for the two states. Also, for DTTs signed by Spain, Spain and (if so) the other contracting state must send a communication to the OECD proving that they have completed the necessary domestic procedures. The following distinctions must be considered:

- For taxes withheld at source, the amendments affect the taxable events occurring from January 1 of the year starting after 30 days have lapsed from the date the OECD receives the communication.
- In the case of other taxes, the amendment of the MLI will take effect for the tax periods starting six months after 30 days have lapsed from the date the OECD receives the communication.
- Regarding mutual agreement procedures, the MLI will take effect for cases submitted to the competent authority after 30 days have lapsed from the date the OECD receives the communication, unless the DTT impedes this.

Finally, as there is no consolidated official version of the DTTs covering the amendments by the MLI, the application of any DTT will require the analysis of its condition as a covered tax agreement under the MLI, and if this is the case, an analysis will be required of the specific aspects that are amended.

Spain's MLI position

As indicated, the purpose of the MLI is to amend the wording of certain provisions of DTTs, providing the contracting states' MLI positions are compatible. Below we summarize the Spanish position.

Regarding the subjective scope, Spain has identified the DTTs that it wants to be covered by the MLI and that are suitable for amendment. However, some of the DTTs Spain has selected will not be amended just yet, as the other state is not yet a member of the MLI (e.g., USA and Brazil). Also, certain DTTs are not on Spain's list due to the parallel bilateral negotiations (e.g., China, Japan and the Netherlands).

The main amendments Spain has selected are as follows:

> Preamble: The preamble of the DTTs signed by Spain will be amended to mention that the DTTs' purpose is not to generate opportunities for non-taxation or reduced taxation through tax avoidance or evasion (including treaty shopping). Spain also wants its preambles to mention that the signing of a DTT means the contracting states want to develop their economic relations and to reinforce their tax cooperation.

> General anti-abuse rule: Article 7 of MLI includes one of the star measures: the principal purposes test ("PPT"). Although the MLI permits the adoption of other measures, Spain has chosen this one and it will be introduced into all DTTs affected by the MLI. This rule involves the introduction of a general anti-abuse rule, which denies the benefits of the DTT when it is reasonable to conclude that the agreement or transaction generating the right to the benefit has, as one of its main objectives, the obtaining of that benefit, except when it is established that its granting in the specific case is in line with the purpose and aim of the DTT's provisions that are relevant for granting the benefit.

> Transparent entities: Spain agrees to introduce in its DTTs that the income obtained by fiscally transparent entities or instruments is understood to be obtained by a person resident in a state only if that state levies tax on its residents for obtaining such income. This means that, although the entity receiving the income is not taxed because it is transparent, it is possible to apply the DTT of the resident state of the person to whom the income is attributed fiscally.

> Permanent establishments: The Spanish position aims to include some of the amendments in the MLI regarding the concept of permanent establishment in the Spanish DTTs. Spain wants to accept the new definition for the commissionaire arrangements (which, so far, have been controversial), by including in the concept the cases in which the agent does not conclude the arrangements but plays a main role that enables another person to do so without a substantial modification, as well as the cases in which there is indirect representation (agents act in their own name but on behalf of

the principal). Also, Spain takes the opportunity to reassert its criteria that there are only two exceptions to the concept of permanent establishment: (i) the independent agent, and (ii) activities of a preparatory or auxiliary nature.

Spain also accepts including in its DTTs a specific anti-abuse rule for cases in which the income is considered received for tax purposes by a permanent establishment subject to low taxation. The state from where the income is sourced can reject the benefits of the DTT (between that state and the state where the parent company is based) if the permanent establishment pays 60% less tax than what its parent company would pay if it were receiving the income. This rule has one exception: that rejection does not apply if the income in question is incidental to an active engagement in an economic activity through the permanent establishment or is related to that activity.

- Dividends and capital gains: The Spanish position includes amendments in the treatment of dividends and capital gains from shares. On the one hand, in line with its domestic regulations, Spain wants the shareholding from which the dividend is derived to have been kept for at least the previous year, so that the dividend can benefit from the reduced taxation under the DTT. Corporate reorganizations do not start over this holding period.

  On the other hand, in the case of transfer of the shareholding to an entity whose assets have been mainly made up of immovable property during the previous year, taxing rights over the capital gains obtained are granted to tax the state where the immovable property is located. In that case, the main new development is this analysis of the situation during the previous 365 days, which does not exist in Spanish national regulations.

- Obligations to correct double taxation: Spain wants to eliminate the obligation to provide the exemption method for certain foreign-sourced income established in some of its DTTs. However, based on the current positions and, unless there are future amendments, this obligation will only be eliminated from the treaties with Slovakia and Poland and will remain in the treaties signed with Brazil and Tunisia, for example.

- Mandatory arbitration: Spain joins the limited list of countries that accept placing unresolved mutual agreement procedures under a mandatory arbitration to settle the differences between the tax authorities regarding application of a DTT. The decision is binding although Spain wants it to not be binding if a different agreement is reached by the tax authorities in the three months after the date of the arbitration decision. In any case, this arbitration system does not totally replace the ordinary litigation process, e.g., Spain excludes from arbitration any matter on which an administrative or jurisdictional body has already issued a ruling or on which a ruling is issued before the arbitration decision.

Spain opts to exclude certain situations from this arbitration: (i) any adjustments based on application of the domestic anti-abuse rules, (ii) cases leading to the committing of tax infringements and tax offenses, (iii) cases of transfer pricing relating to elements of income or wealth not taxed in another jurisdiction or protected under the Arbitration Convention 90/463/EEC , and (iv) when the relevant authorities agree that the resolution of the case through arbitration is not appropriate.

Lastly, we will cover aspects in the MLI that Spain does not accept and that will not undergo changes in its DTTs:

- Conflict of residence of legal entities: In the case of dual-resident legal entities, the MLI proposes replacing the tie breaker test of the entity's effective place of management with a mutual agreement procedure between the tax authorities. However, Spain has opted to not apply this rule, meaning that the Spanish agreements covered in the MLI will not include this amendment.
- Taxation of residents: The MLI proposes qualifying the basic principle under which a DTT does not change a state's capacity to tax its own residents. However, the Spanish position rejects this.
- Calculating deadlines and the concept of permanent establishment: Spain does not consider it necessary to introduce a specific rule combating the fragmentation strategies of contracts aimed at avoiding a project from reaching the duration that would determine the existence of a permanent establishment.
- Mutual agreement procedure: The MLI will not substantially change the Spanish DTTs in relation to the mutual agreement procedure between tax authorities (taxpayers can file for this procedure when they consider that taxation has occurred that is contrary to the provisions of a DTT), although Spain has committed to consider those procedures in its DTTs and to implement the correlative adjustments in the case of a tax reassessment in the other state.

For additional information, please contact Cuatrecasas.