

Spain: Draft Resolution provides additional guidance on foreign look-through entities

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Executive summary

The Spanish Ministry of Finance issued a draft Resolution on 5 November 2019 to clarify the interpretation of the Spanish Nonresident Income Tax (NRIT) rules governing which foreign entities should be regarded as look-through for Spanish tax purposes. This draft is now subject to public consultation until 26 November 2019.

Detailed discussion

Background

The Spanish NRIT Law sets forth look-through tax treatment for entities whose legal nature is identical or analogous to that of look-through entities incorporated under Spanish law.

However, the current rules do not include any further guidance on what those legal features are and, in particular, whether the tax treatment applicable in the country in which the entity is incorporated or in which the partners or members reside is relevant for these purposes.

The Spanish Tax Authorities have issued several rulings regarding the look-through characterization of certain foreign entities. In these rulings, the tax treatment of such entities was taken into consideration as one of the factors considered to determine whether they are "identical or analogous" to Spanish look-through entities.

Objective of the draft Resolution

The aim of this draft Resolution is to adapt the Spanish interpretation to that given by the Organisation for Economic Co-operation and Development (OECD) in its 1999 report entitled “The Application of the OECD Model Tax Convention to Partnerships” and to ensure that no mismatches resulting in lack of taxation occur.

The draft Resolution lists some of the foreign entities which have been characterized in existing rulings as look-through entities for Spanish tax purposes, which include the United Kingdom Limited Partnership and Limited Liability Partnership, the German Kommanditgesellschaft (KG) and the Dutch closed Commanditaire Vennootschap (CV). The case of the closed CV is cited by the draft Resolution as a landmark one, as the ruling confirmed that the tax treatment was relevant for these purposes (and was, in fact, the only difference with an open CV, which would not be regarded as a look-through entity for Spanish tax purposes).

In this draft Resolution, the Spanish Tax Authorities consider that the three characteristics which would be relevant for a non-Spanish tax resident entity to be considered as a look-through entity for Spanish tax purposes are:

- ▶ The income obtained by the entity is not taxed at the level of the entity (i.e., it is not subject to tax on income).

- ▶ The income obtained by the entity is attributed for tax purposes to the persons who have an interest in that entity (the members of the look-through entity), regardless of any distribution effectively made by the entity.
- ▶ The income allocated to the members of the look-through entity keeps the same characterization as the relevant item of Spanish-source income.

Impact

Given the lack of conclusive guidance on the characterization of foreign entities as look-throughs under Spanish rules, the criteria included in this draft Resolution will provide additional certainty on how to approach foreign look-through vehicles for Spanish tax purposes.

Also, the fact that the Spanish approach will be aligned with that of the OECD will help prevent mismatches and ensure a more coordinated treatment at an international level.

The draft Resolution is now subject to public consultation until 26 November 2019. EY Spain will be involved in the preparation and submission of observations to the Spanish Tax Authorities.

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