# Spanish Tax Alert

## Luxembourg Specialised Investment Funds ("SIF") and the application of controlled foreign corporation antiabuse Tax Regime

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The Spanish General Directorate of Taxes ("DGT"), through the recently published binding ruling V2701-13, of September 10th 2013 ("RDGT"), has clarified to some extent the uncertainty existing as regards the potential application of the controlled foreign corporation tax regime ("CFC") in connection with the acquisition of shares in a Luxembourg Specialised Investment Fund ("SIF") by Spanish entities.

Previously, it should be recalled that the CFC regime seeks to avoid certain structures which are considered to be abusive since they serve as artificial company relocations; for example, the CFC regime seeks to avoid the establishment of an investment vehicle corporation between the source of income and the ultimate holder of the capital with the intention to ensure that such income is taxed at the level of the investment vehicle corporation instead of being taxed by the country of residence of the ultimate holder of the capital. Indeed, the CFC regime presumes that income which is not derived from the development of business activities (income from passive investment) obtained by corporations resident in low-tax or no-tax jurisdictions, will be attributed to the Spanish residents shareholders as if they would have directly obtained that income without the mediation of the investment vehicle corporation.

The facts on which the binding ruling is based are as follows: a Spanish entity intends to channel its financial investments through the acquisition of a stake in a Luxembourg SIF with the legal form of an investment company ("SICAV") and an open structure (accessible to "well-informed" investors), which carries out its activities fully and effectively in Luxembourg, and has a management company and a Board of Directors.

The DGT ruling does not provide any clarification on the interpretation and existence of the circumstances determining the application of the CFC regime (participation in the non resident vehicle corporation, level of taxation under the law of the source country and type of income earned by the vehicle corporation).

Nevertheless, with respect to the condition concerning the "level of taxation" of the SIF, the DGT is conclusive and states that the fact that the SIF is subject to an annual tax in Luxembourg amounting to the 0.01% of the quarterly value of its net assets, does not mean that the SIF is subject to a tax which is identical or substantially similar to the Spanish Corporate Income Tax, since a tax levied on the value of its net assets should be qualified as a wealth tax rather than as an income tax, as required by Article 107 of the Spanish Corporate Income Tax Law ("CIT Law"), as approved by Royal Decree-Law 4/2004, of 5 March, which regulates the TFI regime.

Finally, the DGT held that as far as the SIF is resident in Luxembourg (Member State of the European Union), the CFC regime will not be applicable, provided that the Spanish entity proves that it was incorporated in that territory for valid economic reasons and carries out business activities (European Union "safe harbor" principles derived from the case law of the European Court of Justice (ECJ) in cases *Cadbury Schweppes* or *Test*

*Claimants in the CFC and Dividend Group Litigation*). However, the DGT failed to examine the criteria to be considered in order to fall within the scope of the European *safe harbor* regulated in paragraph 15 of Article 107 of the CIT Law; thus, it is unclear under which circumstances a SIF resident in Luxembourg that operates as an investment vehicle corporation -in the present case, managed through a management company but with a local Board of Directors- may be protected by the above-mentioned *safe harbor*. On the contrary, it may be inferred from the DGT´s ruling that the CFC regime is applicable in cases such as the one at hand, although it seems that the DGT has avoided such a straightforward statement for strategic and tax policy reasons, possibly to prevent any dispute regarding the EUlaw.

This being so, the main implications of the DGT´s ruling is the highlighting of the problems that arise from certain investment structures as the one at hand, which combined with other circumstances, such as the progressive economic internationalization, the increased collaboration between national Tax Administrations and the increase in the application of the CFC regime in terms of tax collection, makes highly recommendable its restructuring or migration to Spain. Such a conclusion may also fall within the scope of other structures under which the investment is directly made by individuals resident in Spain, where the application of the CFC regime has raised some doubts notwithstanding the provisions of Article 91.13 of the Spanish Personal Income Tax Law.