Spanish Tax Alert

The New Tax treaty between the United Kingdom and Spain

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Last March 14th, 2013, the Convention between the Kingdom of Spain and the United Kingdom of Great Britain and Northern Ireland (hereinafter referred to as "**Spain**" "**UK**" or collectively as the "**Contracting States**") for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital (hereinafter referred to as the "**new Tax Treaty**") was signed in London.

The ratification process will now start in the Contracting States, and once both of them have completed their Parliamentary procedures and exchanged diplomatic notes, after the period of three months, the new Tax Treaty will enter into force and have effects. It is expected that the new treaty will enter into force during this year.

The current Tax Treaty is dated of October 21st, 1975 and was amended in 1993, so the new Tax Treaty will replace it in order to modernise the tax framework of the relationship between both countries, as has long been requested from business communities of both Contracting States.

The most relevant changes introduced by the new Tax Treaty are included in the present document. However, we can highlight the interests' and royalties' withholding tax rates, which have been reduced to 0%; the dividend withholding tax rate, which has been reduced to 10% for portfolio investors and to 0% in case of direct investors and pension schemes.

- ***Taxes covered (article 2)***

  The wording of the new Tax Treaty includes an open list of taxes on income and on capital covered by the Convention, while in the current Tax Treaty included an exhaustive list.

- ***General definitions (article 3)***

  The new Tax Treaty includes UK **trusts** in the definition of "person", which is an entity not recognised in general terms from a Spanish standpoint. It refers to trusts resident of the UK under its domestic law.

  The new Tax Treaty also provides a definition of **pension funds** in both Contracting States.

  According to the definition of a qualifying Spanish pension fund, the new Tax Treaty requires that the contributions to the said pension fund must be deductible from the taxable base of the Spanish Personal Income Tax.

  However, according to Spanish domestic tax regulations, the deductible amount of contributions to a Spanish pension fund is limited to an annual amount. Therefore, it is unclear whether a Spanish pension fund receiving contributions that exceed the said deductible limits would be entitled to the Tax Treaty benefits.

- ***Residence (article 4)***

  The new wording of the Tax Treaty introduces certain rules for the application of the Convention when an item of income, profit or gain is obtained by a partnership, a trust, a group of persons or other similar entity, as summarised in the table below:

		Partnership, trust, group of persons or other similar entity:		
		Established in the other contracting State	**Established in the *source State***	**Established in a third State**
Item of income (including income, profit or gain)	**Treated as income of beneficiaries, members or participants in the other contracting State**	Is eligible for the benefits of the Convention that would be granted if the income was directly obtained by the beneficiary, member or participant resident in the other contracting State (art.4.4.a) of the tax treaty)	Can be taxed under the tax laws of the source of income State without any restriction (as long as the item of income is treated as income of the partnership, trust, group of persons or other similar entity under the tax laws of the source of income State) (art.4.4.c) of the tax treaty)	Is eligible for the benefits of the Convention that would be granted if the income was directly obtained by the beneficiary, member or participant resident in the other contracting State (art.4.4.e) of the tax treaty)
	Treated as income of the partnership, trust, group of persons or other similar entity in the other contracting State	Is eligible for the benefits of the Convention that would be granted to a resident of the other contracting State (art.4.4.b) of the tax treaty)	Is not eligible for the benefits of the Convention (art.4.4.d) of the tax treaty)	Is not eligible for the benefits of the Convention (art.4.4.f) of the tax treaty)

It should be noted that the term resident of a contracting state includes a pension scheme established in that State. Article 4 of the treaty also contains the usual tie-breaker rules for the elimination of double residence.

- ***Residence and remittance basis rules (article 23)***

  The treaty contains a miscellaneous provisions clause dealing with the application of its rules with regard to the remittance basis provisions, providing that the tax reductions or exemptions laid down by the treaty only applies in the source state when the income is taxed in the other contracting State. The miscellaneous provisions clause of the treaty also contains a general antiabuse rule.

- ***Income from immovable property (article 6)***

  The new Tax Treaty matches the tax treatment of immovable property held directly and any kind of time-share rights in respect to such properties that exceed two weeks per year. The current Treaty only allowed the taxation in the State where the property is situated of such rights when they exceed four weeks per year.

  Moreover, the new Tax Treaty introduces a new paragraph whereby in case of indirect ownership of immovable property through shares or other rights that entitle the owner to the enjoyment of the property, the income derived from the direct use, lease or any other form may be taxed in the State where the property is situated.

- ***Associated enterprises***

  A provision has been introduced in the wording of the new Tax Treaty regarding transactions between associated enterprises that do not comply with the arm's length principle. In these cases, an appropriate adjustment must be made so that the same profits are not double taxed in the Contracting States.

- ***Dividends, interest and royalties (articles 10, 11 and 12, respectively)***

  The following table summarises the major changes in the withholding taxes applicable to these kind of income:

		Type of income		
		Dividends	**Interest**	**Royalties**
Withholding taxes	**Current Tax Treaty**	15% in general; 10% for qualifying companies (10% of the capital); and 15% regarding profits distributed allocable to a permanent establishment in the other Contracting State	12%	10%
	New Tax Treaty	15% for dividends distributed by REITs/ SOCIMIS; 10% in general; 0% for qualifying companies (10% of the capital) or pension schemes	0%	0%

- ***Capital gains (article 13)***

  Regarding capital gains, the new Tax Treaty includes a specific provision for shares or other rights on companies (excluding companies traded on a Stock Exchange) for which more than 50% of their value is based on real estate. Capital gains derived from the transfer of the said shares may be taxable in the Contracting State where the immovable property is situated. The same applies to shares or other rights which directly or indirectly entitle the owner to the enjoyment of immovable property situated in one Contracting State, which may be axable in the said State.

- ***Other income (article 20 and Protocol V)***

  According to this residual clause, the income paid to a resident of a Contracting State out of income received by trustees or personal representatives administering the estates of deceased persons resident of the other Contracting State, will be treated as the income received by the trustees or personal representatives.

  The residents of Spain who are beneficiaries of a UK trust will be taxed in Spain on the gross amount of income they receive or are entitled to receive from the trust. In such a case, Spain shall eliminate the double taxation through the foreign tax credit method.

- ***Capital taxation (article 21)***

  Capital constituted by shares or other rights on companies (excluding companies traded on a Stock Exchange) for which more than 50% of their value is based on real estate and shares or other rights which directly or indirectly entitle the owner to the enjoyment of immovable property may be taxed in the Contracting State where the property is situated.

- ***Mutual agreement and Arbitration procedures (article 25)***

  In case the Contracting States are unable to reach an agreement regarding a mutual agreement procedure in the term of two years, the new Tax Treaty establishes that the issues shall be submitted to arbitration at the request of the taxpayer as long as certain conditions are met.

- ***Exchange of information (article 26)***

  A new article is introduced in the wording of the new Tax Treaty regarding the exchange of relevant information for the Convention purposes or for domestic tax laws purposes of both Contracting States. The new exchange of information clause is fully in line with that provided by article 26 of the OECD Model Convention (2010).

- ***Double Taxation Relief (article 22)***

  In Spain, the double taxation shall be eliminated through the application of either the provisions of the domestic law (i.e., the participation exemption rules, the PE exemption method) or the foreign tax credit rules laid down by the treaty that follows article 23 B of the OECD Model Convention, in accordance with the internal legislation of Spain.