CARLTON FIELDS

Can the Spanish ETVE Be Used to Finance Foreign Operations?

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The Spanish ETVE (a tax-exempt Spanish holding company) has become a popular vehicle through which U.S.-based multinationals hold all of their non-U.S. operating subsidiaries. If only it could also be used to finance the working capital needs of those subsidiaries... Well, now it can!

The ETVE Purely as a Holding Company Spain has one of the most extensive treaty networks in the world, especially with Latin American countries. U.S.-based multinationals can take advantage of the Spanish treaty network by holding their non-U.S. operating subsidiaries through the Spanish ETVE. The results include:

1. Reduced Source-Country Withholding Taxes: The dividends from the operating subsidiaries to the ETVE generally benefit from a lower withholding tax rate pursuant to most treaties with Spain;
2. Spanish Participation Exemption: Full exemption from tax in Spain for dividends received (and capital gains generated by) the Spanish ETVE with respect to the stock of its operating subsidiaries; and
3. No Spanish Withholding Taxes: Dividends paid by the Spanish ETVE to its U.S. parent are exempt from Spanish withholding taxes.
   As a result, the dividends from the operating subsidiaries flow through Spain to the U.S. parent free from all Spanish taxes.

The ETVE as a Financing Vehicle If the ETVE itself loans funds to its operating subsidiaries, the interest income will be taxed in Spain (since the "participation exemption" applies to dividends, but not to interest income). However, we've learned from a correspondent firm in Spain that the Spanish ETVE may lend funds indirectly through a non-Spanish branch without being taxed in Spain. In addition, the Spanish ETVE, together with its non-Spanish branch, still qualifies for the benefits of the Spanish treaties, including the lower withholding rates on interest remitted from the operating subsidiaries to the branch. Moreover, the dividends remitted by the ETVE to its U.S. parent continue to be exempt from Spanish withholding taxes. **Technical Aspects of the ETVE Financing Structure** Under Spanish tax laws, the income of a branch of a Spanish company located outside of Spain is

exempt from Spanish corporate income tax provided certain requirements are met. Generally, the foreign branch must be actively engaged in a trade or business outside of Spain, must be subject to corporate income tax (similar in nature to the Spanish tax) on income, and cannot be a resident of a tax haven jurisdiction. Thus, the earnings of the foreign branch (for example in Switzerland, Ireland or possibly Malta or Uruguay) of a Spanish ETVE conducting financing activities would not be subject to Spanish corporate tax, provided the branch is engaged in a business activity and the jurisdiction in which the branch is located has a corporate tax. Pursuant to the model OECD treaty commentaries, withholding tax rates on interest payments are governed by the provisions of the tax treaty in force between the source state (i.e., the countries where the operating companies are located) and the state where the company's head office and tax residence is located (i.e., Spain) but not where the branch is located. Thus, in the structure discussed above, it is imperative that the ETVE's head office (as determined under OECD model treaty principles) be located in Spain. Most of the Latin American countries that have income tax treaties with Spain share the OECD approach.

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