

# TAXATION SYSTEM FOR THE CANARY ISLANDS SPECIAL ZONE

## **1. Introduction**

At a meeting on January 18, 2000, the European Commission, approved the compatibility of the legislation for State Aid (Ayudas del Estado) for the Canary Islands Special Zone (Zona Especial Canaria, hereinafter ZEC).

The ZEC is a geographic area that allows companies that set up business, to benefit from a special taxation system characterised by a low taxation rate (between 1% and 5% in Corporate Income Tax) for fiscal years starting before December 31, 2008.

The geographical area referred to, covers the entire Canary Island Archipelago for service companies, whereas companies that transform or manipulate goods must be located within certain enclosures close to the harbours and airports in this territory.

## **2. Requirements for applying for the special system**

To benefit from this special system the following requirements must be met:

- Constitution of a new mercantile company, domiciled and with its headquarters in the Canary Islands.
- The company object must be one of those listed in Annex 1.
- It is necessary to be registered in the Official Entities Registry (Registro Oficial de Entidades) of the ZEC (after having presented an Annual Report and the authorisation of the Consortium).
- The company must make an investment in tangible assets of 16,638,600 PTAs (€100,000) within the first two years and maintain the investment during the period the special system is applicable.
- Create at least 5 employment positions within the first 6 months of the granting of authorisation and at least sustain this average level of employment.
- Guarantee or deposit for the registration fee (approx. 100,000 PTAs).
- Payment of the registration fee (approx. 100,000 PTAs. + 150,000 PTAs a year)

### 3. Fiscal benefits

#### 3.1. Corporate Income Tax

##### a) Reduced tax rate

<b>Net Creation of Employment</b>	<b>First 3 years*</b>	<b>Following 4 years*</b>	<b>Remainder until 2008</b>
<b>Between 5 and 8 employees</b>	1%	2.5%	5%
<b>Between 8 and 12 employees</b>	1%	2.25%	4.5%
<b>Between 12 and 20 employees</b>	1%	2%	4%
<b>More than 20 employees</b>	1%	1.75%	3.5%

\* For companies authorised in 2000 and 2001.

A reduction of 20% is also provided for activities that are not widely present in the Canary Islands.

##### b) Portion of the Taxable Base on which the reduced taxation rate is applicable

Obtained by multiplying by 100 the result of dividing the following by the total income and other revenue components of the taxable base:

- + Transfers of corporate assets in the ZEC;
- + Transfers of real estate located within the ZEC which are a part of the fixed assets used for carrying out the activity;
- + The rendering of services with resources related to the ZEC
- + Operations carried out from the activity centres of the entity established in the ZEC, destined for subsidiaries located outside it
- Operations received by the activity centres of the ZEC entity located within its geographic environment, from subsidiaries located outside the ZEC.
- Transfers of assets acquired by the ZEC entity from other entities as a consequence of transactions falling under the special system for mergers, de-mergers, asset contributions and equity swaps.

##### c) Limits on the taxable base on which the reduced rate may be applied (in million PTAs)

The taxable base on which the reduced Corporate Income Tax rate is applied, has certain limits depending on the type of activity and the number of employees in the company.

<b>No of employees</b>	<b>Wholesale trade</b>	<b>Services</b>	<b>Industry</b>
<b>Between 5 and 8</b>	187.2	249.6	299.5
<b>Between 8 and 12</b>	249.6	332.8	399.3
<b>Between 12 and 20</b>	374.4	499.2	598.9
<b>Between 20 and 50</b>	998.3	1,331.1	1,530.7
<b>Between 50 and 200</b>	2,246.2	2,994.9	3,593.9
<b>More than 200</b>	12,478.8	16,638.6	19,966.3

#### **d) Distribution of dividends**

The companies that obtain dividends from the entities under the ZEC taxation system have the right to a deduction for double taxation relief.

In the case of private individuals, these will have the right to apply a deduction of 40% of the dividend received, as double taxation relief.

With regard to non-resident individuals or entities, the dividends obtained will be exempt from taxation in Spain, as long as they are not related to countries or territories considered as tax havens.

### **3.2. Other taxes**

The entities to which the ZEC system has been applied, are exempt from the Transfer Tax and Stamp Duty, for the acquisition of assets and rights used for carrying out the activity, as well as other corporate activities, except its liquidation.

On the other hand, the delivery of goods and the rendering of services with other ZEC entities will be exempt from taxation for the General Canary Island Indirect Tax. In addition, the signing of tax agreements with local organisations to reduce local taxes is provided for.

## ANNEX 1: LIST OF ACTIVITIES

- **Manufacturing, transformation, handling and wholesale distribution of goods activities:**
  - Fishing.
  - Food, beverage and tobacco industry.
  - Clothing industry and furriers.
  - Leather and footwear industry
  - Paper, publishing, graphic arts and reproduction of recorded medium industry.
  - Chemical industry.
  - Prefabricated building components.
  - Construction of machinery and mechanical equipment industry.
  - Electric material and equipment, electronic and optical industries.
  - Manufacturing of furniture; other manufacturing industries.
  - The recycling industry.
  - Wholesale trade and trade brokers.
  
- **Service activities**
  - Transport and related activities
  - Software activities
  - Services related to the exploiting of natural resources and the elimination of waste.
  - Services related to research and development
  - Other business activities
  - Specialised training and postgraduate studies services.

# **TAXATION SYSTEM FOR FOREIGN SECURITY HOLDINGS (ENTIDADES DE TENENCIA DE VALORES EXTRANJEROS- ETVE)**

## **1. Introduction**

In order to make Spanish companies more international, Royal Decree 3/2000, of June 23, has amended the system applicable to ETVEs legislated in the Corporate Income Tax Law (Ley del Impuesto sobre Sociedades - LIS). The amendments are an improvement of the fiscal treatment of income from outside sources, making dividends and capital gains generated by the transfer of equity in non-resident entities tax exempt, provided they comply with the legal requirements.

## **2. Concept of ETVE**

The LIS defines ETVEs as those entities whose main object consists in the following activities:

- The management and handling of securities representing equity in non-resident entities, with an equity holding of at least 5%.
- The investing of financial resources by means of an adequate organisation of human and material resources.

In addition, ETVEs may render all types of additional services, including those of a financial nature, provided they are rendered to non-resident partly-owned entities or entities that form a part of a group of companies belonging to the ETVE.

## **3. Exemption of dividends or profit sharing**

The dividends or profit sharing arising from partly owned entities are not added to the taxable base, provided the following requirements are complied with:

### **a) Equity holding**

No less than 5% must have been continuously owned during the year prior to the day on which the profit is callable.

### **b) Tax system for non-resident entities**

The partly owned entity must be subject to and not exempt from a tax of an identical or similar nature to the Corporate Income Tax and must not be resident in a country or territory considered a tax haven.

### **c) Activity carried out by the non-resident entity**

The income from dividends or profits from partly owned entities, must be at least 90% derived from business activities carried out abroad.

When the activity is the general manufacturing or transformation of products, there is no residence requirement on the buyers of the goods produced by the non-resident entity, therefore these entities may reside in Spain.

#### **4. Exemption of the income obtained on the transfer of equity holding**

The income obtained by an ETVE on transferring its share in any of the partly owned non-resident entities is exempt from Corporate Income Tax, providing the following conditions are complied with:

- a) That the holding percentage has been held continuously during the year prior to the day on which the transfer takes place.
- b) That the non-owned entity is subject to and not exempt from a tax of an identical or similar nature to the Corporate Income Tax and is not a resident in a country or territory legally classified as a tax haven.

This condition must be complied with for each and every fiscal year that the ownership has been held. Otherwise, the income obtained from the transfer must be added to the taxable base of the Corporate Income Tax, in full.

- c) That the non-resident partly owned entity obtains income derived from the carrying out of business activities abroad in all the fiscal years during which ownership was held.
- d) That the buyer, if a resident in Spanish territory, is not a related-party to the transferring ETVE.

#### **5. Loss of value of the equity holding**

The loss of value of the equity holding derived from the distribution of profits by any of the partly-owned non-resident entities is not added to the taxable base of the ETVE, irrespective of the format or tax year in which the loss of value takes place, except when the amount of these profits have been taxed in Spain from a prior transfer of the equity holding.

The non-inclusion in the taxable base of the loss of value is only applicable if it is caused by the distribution of profits. If the loss of value is due to operating losses incurred by the non-resident partly owned companies, this loss of value will be a part of the taxable base of the ETVE.

Aside from this limitation, there are no other restrictions on the deductibility of expenses incurred by the ETVE.

#### **6. Income subject to Corporate Income Tax**

The remaining income obtained by the ETVE is included in the taxable base and is subject to Corporate Income Tax. This would be the case, for example, of the income obtained from rendering support services to the partly owned non-resident companies.

With regard to this income, international double taxation relief agreement ruling will be applicable, both legally and financially.

## **7. Distribution of profits**

### **7.1. Resident partner in Spanish territory**

The profit share received will not have the right to double taxation relief on dividends, but will be eligible for an international double taxation relief deduction, both legally and financially, with respect to taxes paid abroad, corresponding to the income from these profits.

### **7.2. Non-resident partner in Spanish territory**

The dividends distributed by the ETVE to non-residents will not be subject to taxation for Non-Resident Income Tax (Impuesto sobre la Renta de No Residentes – IRNR), as this income is not deemed to have been earned within Spanish territory.

Nevertheless, when the recipient of the dividend is a resident individual or entity in a country or territory classified as a tax haven, the dividend shall be considered as having been obtained in Spain and will consequently be subject to a tax rate of 25%.

## **8. Application of the system**

The application of the ETVE taxation system requires the prior authorisation of the Taxation Authorities (Administración Tributaria).

The application to the Taxation Authorities must include the following data:

- Articles of association of the entities or their draft.
- A listing of equity holding in non-resident entities.
- Identification and description of the activities of the non-resident entities, attaching annual accounts.
- The last approved Balance Sheet or opening Balance Sheet of the applicant entity.
- Description of the organisation structure of the applicant entity.

A decision must be released within three months, as from the date of the application. If this period expires without express resolution, the application will be deemed to have been accepted and therefore, the system authorised.