68.
Spain

Introduction

During various years by now, the Spanish tax authority has been increasing, and continues to increase, its awareness of and attention to transfer pricing. The legislation enacted in 1995, the statutory regulations approved in 1997 and modifications effective as of 1 December 2006, include the general principles for dealing with transactions between related parties. They also state the procedure to be followed by taxpayers seeking advanced pricing agreements (APAs) and the basic procedure to be followed by tax auditors in the field for reassessing the transfer price agreed between related parties.

Article 16 of Spanish Corporate Income Tax Law (CITL) was modified by Law 36/2006, which came into force on 1 December 2006, and affects transactions carried out in fiscal years starting after that date. The legislation provides that transactions between related entities and persons, including domestic as well as cross-border transactions, should be valued and declared at arm's length for tax purposes. The current set of transfer pricing rules and regulations are closely aligned with international best practices, as provided in the Organisation for Economic Co-operation and Development (OECD) Guidelines and the European Union Joint Transfer Pricing Forum (JTPF). Previous to the current legislation, making adjustments to related party prices was a power of the Spanish tax administration only. It is also important to note that the modifications that were introduced by the current legislation were included as part of the Bill of Measures Against Tax Fraud, which highlights the level of importance given to transfer pricing in Spain.

Statutory rules

Spain's legislation concerning transfer pricing is contained in Articles 16 and 17 of Law 36/2006, modifying the CITL, in Royal Decree 1793/2008 of 3 November, amending the CITL Regulations and in Article 41 of Law 35/2006, modifying the Personal Income Tax Law (PITL).

The legislation provides that for corporate tax purposes related party transactions should reflect arm's-length pricing. The transfer pricing methodologies described in the Spanish transfer pricing legislation largely follow those contained in the OECD Guidelines. The legislation includes the profit-based method transactional net margin method (TNMM) which was not formally accepted in the previous legislation. Furthermore, this legislation specifies the existence of a transfer pricing methodologies hierarchy and specifies that, where possible, the transactional methods should be used to establish an arm's-length price in preference to profit-based methods.

Article 41 of the PITL establishes, as a general principle, that transactions between related persons or entities will be priced in accordance with the arm's-length principle.

The procedure for establishing the arm's-length value and, where necessary, for substituting the value declared in a taxpayer's return is set out in Articles 16 and 17 of the CITL.

The procedure to be followed by tax authorities when seeking to apply the arm's-length principle through the course of a tax inspection is stated in Article 16 of the Corporate Income Tax Regulations (CTR). A brief description is as follows. First, if the other party of the related party transaction has also been taxed under the CITL or PITL, it is notified by the tax authorities that the transaction has been placed under scrutiny. This notification explains the reasons for the adjustment to the company's profit and the methods, which could be used in determining the normal market value. The related party has 30 days to present any facts or arguments that it believes are pertinent to the matter.

Having examined both related parties' arguments, and immediately prior to preparing the document in which the arm's-length value shall be established, the methods and criteria to be taken into account are made available to the parties. The parties then have 15 days in which to formulate additional arguments and whatever documents and evidence they deem appropriate.

Either party has the right to dispute the outcome of the proceedings, in due course. If they do not, the normal market value established by the tax authorities becomes effective for all tax periods under assessment in accordance with Articles 16 and 17 of the CITL. If the outcome is indeed contested by either of the related parties, its application is suspended pending a final decision. In the meantime, tax assessments are deemed to be provisional.

The Spanish CITL includes provisions dealing with APAs. APAs can be unilateral or bilateral, and normally refer to pricing arrangements but can also cover research and development (R&D) expenses, management fees and thin capitalisation. Separate provisions deal with contributions made for R&D purposes and management fees.

Documentation

From 19 February 2009 onwards, Spanish taxpayers are required to produce group-level and taxpayer-specific documentation for each tax year. Before 2009, no requirement for formal documentation existed, with the exception that during an inspection, explanations could be demanded, as with any other transaction that influences tax results.

In this sense, Article 16.2 of the CITL establishes as a general rule that related persons or entities must keep available for the tax authorities such documentation as from the end of the voluntary return or assessment period in question. The royal decree implements this statutory requirement by drawing on the principles contained in the EU Code of Conduct on transfer pricing documentation and requires the taxpayer to produce, at the request of the tax authorities, documentation, which, in turn, is divided into two parts:

- documentation relating to the group to which the taxpayer belongs, and
- documentation on the taxpayer itself.

With regard to the first year in which the documentation obligations must be applied, the documentation obligations must be deemed to apply to transactions performed on or after 19 February 2009.

The royal decree also establishes the following instances in which there is no documentation requirement for related party transactions:

- Transactions carried out within a consolidated Spanish fiscal group.
- Transactions carried out by economic interest groups and temporary business associations.
- Transactions involving the purchase or sale of publicly traded shares.

At the same time, the royal decree establishes reduced documentation obligations for (1) related party transactions involving small companies (net revenues for the consolidated group of less than 8 million euros (EUR) in the previous tax year) and (2) individual persons. Finally, it should be noted that documentation is required for transactions with entities, related party or not, resident in tax havens.

Legal cases

Under the former legislation (1978 CITL), the Central Treasury and Tax Court (*Tribunal Económico Administrativo Central* (TEAC), an administrative body included within the Tax Administration but acting independently of the tax audit authorities), had created a solid administrative doctrine that was consistently applied. It also established some important principles for dealing with transfer pricing issues. These principles are set out below:

Comparable uncontrolled market price

- The establishment of a comparable uncontrolled market price is extremely difficult and requires that:
  - the same geographical market is used as a reference
  - similar or identical goods be compared
  - the volume of transactions compared is identical
  - the comparison be made at the same stage of the production/distribution process, and
  - the transactions being compared are carried out within the same period of time.

Transfer pricing adjustments

- Where the above information is not available, transfer pricing adjustments may be made by a tax inspector in accordance with the OECD Guidelines (i.e. using the resale price or cost plus), taking the following issues into consideration:
  - To make an adjustment to reported profits successfully, the authorities must prove that the transaction has not been carried out at market value. The fact that the transactions are between related companies does not automatically mean that the transfer price does not comply with the arm's-length standard.
  - The legal bases and reasons behind the normal market value proposed by the authorities must be disclosed; otherwise the taxpayer could be deprived of information necessary to defend its position.

Intragroup services

- Referring to intragroup services, the Ministry of Finance issued some rulings on the matter stating that:

- for valuation purposes, any method included in the 1979 OECD Guidelines could be applied
- the burden of proof lies with the taxpayer. The taxpayer is therefore required to prove that:
  - the services have in fact been provided
  - the service provider incurred in expenses when rendering such services, and
  - the service provided added economic value to the related entity receiving such services.

Additionally, under the former legislation, the courts ruled on some legal cases that followed the above-mentioned principles.

Regarding the current legislation, the Spanish tax authorities and the jurisprudence issued by the tribunals have widely used the OECD Guidelines to apply or interpret the Spanish transfer pricing rules and regulations.

In particular, the TEAC is making an extensive and intensive use of the OECD Guidelines. Some interesting TEAC's resolutions are mentioned below:

- RTEAC 7 June 1994; RTEAC 22 October 1997; RTEAC 29 January 1999.
- RTEAC 9 March 2000; RTEAC 1 December 2000; RTEAC 26 March 2004.
- RTEAC 8 October 2009; RTEAC 22 October 2009.

Until recently, the Spanish High Court of Justice (STS) ruled on just a few cases regarding transfer pricing issues. In line with the heightened interest given to transfer prices in 2007, these rulings went against the taxpayer. The rulings dealt with various related party transactions, including management fees, customs regulations and purchase of active ingredients.

- STS 11 February 2000; STS 15 July 2002.
- STS 4 December 2007; STS 22 January 2009; STS 30 November 2009.

Management services and R&D cost-sharing arrangements

The section of the legislation dealing with management services is now included within a more general definition of 'services'. The deduction of expenses for services provided by related parties is subject to the condition that the services provided produce or can produce an advantage or benefit to the receiver.

Where it is not possible to separate the services provided by the entity (i.e. directly charging), it is possible to distribute the total price for the services between all beneficiaries of the services in accordance with rational distribution criteria. These criteria need to take into account not only the nature of the service but also the circumstances surrounding the provision of services as well as the benefits obtained (or that can be obtained) by the beneficiaries of the services.

The deduction of expenses derived from cost-sharing arrangements (not only related to R&D) between related parties is subject to the following:

- The participants to the arrangement must be able to access the property (or the rights to the property having similar economic consequences) of the resulting assets or rights being subject of the cost-sharing arrangement.

- The contribution of each participant must take into account the anticipated benefits or advantages that each participant expects to obtain in accordance with rational criterion.
- The agreement must contemplate variations in circumstances and participants, establishing compensatory payments and any other adjustments that may be considered necessary.
- The agreement must comply with the documentation requirements to be established at a later date.

Burden of proof

The statutory regulations state that taxpayers should value transactions with their related parties at market prices and also indicate how that value has been calculated (Article 16 of the CITL and Article 41 of the PITL).

This represents an important change to the rules that has been introduced by the current legislation (previously the burden of the proof lay with the tax authorities).

Should any discrepancies regarding the suitability of the transfer prices arise in the course of a tax review, it is in the taxpayer's interest to present as much evidence as possible in support of its prices. Detailed evidence presented by the taxpayer helps reduce the likelihood of the authorities proposing an adjustment and imposing penalties. For these reasons, it is necessary that the taxpayers comply with the obligation to produce documentation.

Tax audit procedures

Selection of companies for audit

Spanish tax inspectors operate on three levels: national, regional and local. National and regional specialist units are responsible for all tax affairs dealing with companies or groups of companies which may deserve close attention for reasons such as size, importance of operations, a distinguished reputation in an economic sector, volume of sales, etc. Such companies and groups are subject to tax audits on a recurring basis. Smaller companies are dealt with at the local level. Transfer pricing issues, historically, were considered as part of a general tax audit and not the subject of a special investigation by itself. However, with the current legislation, transfer pricing audit activity has increased significantly. Numerous audits have been initiated whose scope is limited to an analysis of the arm's-length nature of inter-company prices.

The provision of information and duty of the taxpayer to cooperate with the tax authorities

In principle, the tax authorities are empowered to collect all the information and data necessary to conduct a tax audit. In general, taxpayers are obliged to provide the tax authorities with such information. Failure to present the accounting registers and documents, which companies are required to keep by law, or failure to provide any data, reports, receipts and information relating to the taxpayer's tax situation, may be considered as resisting or hindering the tax audit.

In general terms, all taxpayers are obliged to present, by law or under a specific request by the tax authorities, any relevant information for tax purposes they may have with respect to third parties, in connection with business, financial or professional relationships held therewith. Any information presented to or obtained by the tax

authorities is considered to be confidential and can be used only for tax purposes and may not be disclosed to third parties, except in those cases stated by law.

The audit procedure

Each inspector is assigned a Personal Confidential Tax Audit Plan for the period, which includes all the taxpayers to be audited by his/her team.

Each taxpayer is entitled to be informed upon commencement of a tax audit, the nature and scope of the audit about to take place, as well as its rights and obligations during the course of such proceedings. The tax audit proceedings must be concluded within 12 months, although, under certain circumstances, this period may be extended to an additional 12 month period.

Inspections are normally conducted at the company's main offices or at the tax authorities' offices.

The procedure is deemed to be completed when the tax auditor considers that all the necessary information required to put together a reassessment proposal has been obtained. Prior to the tax auditor drawing up his/her proposal, the taxpayer is given the opportunity to formulate allegations. A tax inspection usually concludes with a reassessment proposal, which the taxpayer can accept or reject in part, or in whole.

Under the royal decree, tax inspectors must file a separate transfer pricing assessment, distinct from any assessments related to other income tax obligations. The contents of the transfer pricing assessment must include a justification of the arm's-length value as determined by the tax inspector and an explanation of how the arm's-length value was determined.

Revised assessments and the appeals procedure

In the event that the taxpayer does not accept the inspector's proposal, a writ of allegations may be presented to the inspector's superiors. Based upon this writ and the tax inspector's extended report, the superior officer can confirm, modify or cancel the additional assessment.

If the taxpayer is dissatisfied with this decision, an appeal may be filed with the office or directly with the TEAC. At this stage of the procedure, the additional assessment must be paid or guaranteed. An appeal against the decision passed by the TEAC may be filed with the ordinary courts of justice.

Additional tax and penalties

With regard to the documentation requirement, the provision of incomplete, inaccurate or false documentation or where the declared values do not coincide with the values derived from the documentation would imply penalties.

The penalty applied depends on whether or not the tax administration assesses a transfer pricing adjustment:

- if there is no adjustment, a penalty of EUR 1,500 is imposed for each missing, inaccurate or false data item; or EUR 15,000 for a collection of missing, inaccurate or false data item, and

- if there is an adjustment, a penalty of 15% of the adjusted amount is imposed, with a minimum of double the penalty that would have been assessed if no adjustment had been made.

However, prior to imposing a penalty under the general regime, the tax authorities must prove that the taxpayer has behaved in a negligent manner. The taxpayer is considered to have acted with due diligence when he/she presents a reliable and full statement and makes the relevant self-assessment under a reasonable interpretation of the regulations, including compliance with the documentation requirement.

A special procedure exists for imposing penalties, which is independent of the normal tax audit procedure. Such a procedure may be commenced by the tax inspector or by a special officer assigned by the chief tax inspector. The tax inspector must provide all relevant data or proof to justify the penalty being imposed. The taxpayer may formulate allegations and present its consent to, or disagreement with, the proposed penalty. The penalty is automatically reduced by 30% if the taxpayer agrees with the penalty proposal.

The taxpayer may appeal against the proposed penalty without necessarily paying or guaranteeing the amount of the penalty being imposed.

Resources available to the tax authorities

A specialist unit dealing with transfer pricing issues has been established. The regional and national tax offices, which are responsible for the larger companies or multinational companies, normally deal with transfer pricing issues during the course of a general tax audit.

In addition, significant resources are being made available to improve inspectors' ability to successfully undertake audits, and active training is taking place. Tax inspectors currently act on their own, although this does not rule out the possibility that they could receive assistance from in-house experts. Additionally, tax inspectors are able to exchange information under the principles established in the OECD Model Tax Convention and in the European Directive 2004/56 on Mutual Assistance.

Use and availability of comparable information

The current transfer pricing legislation, for the first time, explicitly recognises the transactional net margin method as an accepted method for justifying the arm's-length nature of prices.

Availability

Annual accounts (including the notes to the accounts and directors' report) are officially registered and therefore publicly available. Databases containing detailed financial information of Iberian companies are available. In certain industries (e.g. the pharmaceutical industry), more detailed information concerning product pricing and profit margins may be obtained. Spanish tax authorities have a natural tendency to employ local comparable companies for benchmarking purposes.

The tax authorities have confirmed their use of databases such as AMADEUS and SABI (the Bureau Van Dijk database containing companies located within the Iberian Peninsula).

Tax authorities have also confirmed that they do not use secret comparables, although very often they request information from other companies that operate in the same sector. This information may be requested individually for specific transactions or in a general manner. In some cases, such information has been used by the authorities to justify a transfer pricing reassessment.

Risk transactions or industries

Transfer pricing is an area of increasing interest for the Spanish tax authorities. So far, they have not concentrated on any particular industry, although emphasis has been placed on the automobile, computer/software and pharmaceutical industries.

Special attention has been directed towards management fees, royalties and loans. In addition, the Spanish tax authorities are quite sensitive to so-called ‘business transformations’ and may assert that a permanent establishment (PE) exists of a foreign party to which significant business functions and risks have been transferred.

Regarding management fees, and as noted, the Spanish tax authorities expect to see the application of rational and continuous cost-allocation criteria and actual evidence of the benefits received from the services.

Limitation of double taxation and competent authority proceedings

In principle, when a transfer pricing adjustment affects transactions between a Spanish company and a non-resident, the mechanisms laid down in the relevant double taxation treaty should be applied. Where the non-resident is within the EU, the provisions of the Arbitration Convention relating to the elimination of double taxation (EC Directive 90/436) can be applied. In relation to MAP proceedings arising from the mechanisms laid down in the double taxation treaties or the provisions of the EU Arbitration Convention, the Royal Decree 1794/2008 of 3 November, approving the regulations on direct taxation-related mutual agreement procedures, establishes different regimes (and the phases within each regime), depending on whether the procedure is initiated by the Spanish or the foreign competent authorities, and depending on which tax administration (Spanish or foreign) has made (or makes) the assessment. In addition, this royal decree regulates the procedure to allow for the suspension of the tax payments when a MAP is initiated.

Advance pricing agreements (APAs)

Spanish law provides taxpayers with a statutory right to seek APAs. The general regulations are contained in paragraph seven of Article 16, and Royal Decree 1793/2008 regulates in detail the procedure for processing and deciding on APAs between related persons or entities, whether of a unilateral nature with the Spanish tax authorities, or bilateral or multilateral, involving other tax authorities.

Article 16.7 of the CITL mentions that the procedure applying to APAs is contained in the CTR. The APA filing procedure is specified in Articles 22 through Article 29 nonies of Chapter VI of Title I of the CTR, which came into force on 19 November 2008. Unilateral, bilateral and multilateral APAs are possible in Spain.

The tax inspection department of the Spanish national tax agency (AEAT) is the administrative body in charge of dealing with APA requests. The procedure for applying for an APA is a two-step process. Step one is a prefiling waiting period of one

month, after which the taxpayer is informed of the basic elements of the procedure and its possible effects. Step two is the actual filing, which takes approximately six months in the case of unilateral APAs.

The information provided to the tax administration in the prefiling and filing stages is used exclusively within the context of the APA, and is applicable only for such purposes. The final resolution is effective for the period of time decided in the agreement, but cannot exceed four years. Additionally, it can be determined that the APA affects the operations of the year in which the APA is agreed as well as the operations of the prior year, as long as the time limit for the tax return/declaration has not been passed.

If the taxpayer's proposal is not approved, the taxpayer has no right to appeal the decision. Taxpayers often file an alternative APA after negotiating any points of contention of the initial proposal with the tax authorities.

The Spanish tax authorities have shown a positive response in the processing and ruling of APAs. Furthermore, providing that no significant changes in the underlying conditions of the APA occur, a taxpayer may request an APA renewal.

Liaison with customs authorities

In practice, there is little communication between the income tax and the customs authorities, despite the fact that there is nothing to prevent an exchange of information. Interestingly, transfer pricing adjustments for income tax and corporate tax purposes do not necessarily need to be reflected in returns filed for customs or for any other indirect taxes.

Laws 35 and 36/2006 introduced some points related to the value added tax. Concerning this tax, it is necessary to evaluate the operations according to the arm's-length standard when there is a directive which provides this. These laws also provide for the liability in cases of collaboration in fraud.

OECD issues

Spain is a member of the OECD and endorses the OECD Guidelines. Actual endorsement of the OECD Guidelines is stated in Law 36/2006, which now includes the transactional net margin method in the Spanish legislation. This method was informally accepted before the current legislation in some specific cases, given appropriate justification; however, it is now formally and explicitly accepted as a transfer price method.

Joint investigations

There is nothing in Spanish law to prevent the authorities from joining with authorities of another state to establish a joint investigation of a multinational company or group. In fact, on more than a few occasions the Spanish authorities have followed such procedures.

Thin capitalisation

On 30 March 2012, the Spanish Government announced the 2012 budget. Together with the budget announcement, the Government approved Royal Decree-Law 12/2012, which introduces a number of relevant changes in the corporate tax area, amongst which is a new thin capitalisation regime.

Spain

The Spanish government has followed the trend set by other European governments and has introduced an interest expense-capping rule that replaces the previous thin capitalisation rules in Spain. The interest expense-capping rule, which applies to both related-party and unrelated party debt, limits the tax relief for net interest expense to 30% of the taxpayer's EBITDA. For entities being part of a tax consolidation, this 30% limit applies to the level of the tax group.

Interest disallowed under the interest expense-capping rule can be carried forward 18 years. On the other hand, when the interest expense in a given year is below the 30% limit, the new rule allows this unused capacity to be carried forward five years.

The interest expense-capping rule does not apply if either (i) the net interest expense does not exceed one million euros; (ii) the taxpayer is not part of a group of companies (as defined in Spanish company law); or (iii) the taxpayer is a financial institution.

New anti-debt-push-down legislation

The aforementioned Royal Decree includes specific language to deny the deductibility of interest from indebtedness with group companies – whether resident in Spain or not – when the debt has been used to acquire shares in other group companies, unless the taxpayer is able to prove that the transaction is supported by valid economic reasons.

As potentially non-tax driven transactions, the Explanatory Memorandum cites group restructurings directly connected to an acquisition from a third party, or cases where there is a true management in Spain of the entities acquired.

The Royal Decree-Law entered into force on 31 March 2012 but the above changes apply retroactively to tax years beginning on or after 1 January 2012.