Inter-American Center of Tax Administrations -CIAT

CIAT GENERAL ASSEMBLY

"INTERNATIONAL TAXATION ASPECTS THAT AFFECT MANAGEMENT OF THE TAX ADMINISTRATIONS"

Subtopic 1.1

"INTERNAL REGULATIONS TO PREVENT INTERNATIONAL TAX EVASION"

Tax Administration State Agency

Spain

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First I would like to thank CIAT and the Argentine Administration for this kind invitation to participate as a speaker at this CIAT Assembly.

The Assembly has focused on an extraordinary important issue such as international taxation and how it affects the tax administrations management.

Economic and technological changes have led to a world where borders have stopped being as tight as before. The transit of goods and persons are now much easier than two decades ago. The pressure of the markets has led our countries to reduce our fiscal barriers for foreign trade by eliminating tariffs through bilateral, regional or global agreements. This change basically started last century and it is a small one if we compare it with the great digital revolution we are in now.

We have also been witnesses of the capital liberation process which does not find obstacles for its free movement. And with such liberalization, the possibility for capital flight increases.

These permanent changes in the economic reality require our tax administrations to be more aware of these changes in order to adapt to the taxpayers' new behavior.

We are currently facing an economic reality which offers more favorable alternative tax regimes to the taxpayer. This has been a widespread concern among tax administrations, stated in various specialized forums, such as the BEPS (*Base Erosion and Profit Shifting*), an OECD initiative or the action plan to strengthen the fight against fraud and tax evasion presented by the European Union.

Due to this internationalization of the economy, many companies not only look for profits through a better economic organization of goods and services, but try to have tax advantages by using, sometimes abusively, inconsistencies in domestic regulations and conventions to avoid double taxation, seeking to create opportunities for what has been called the double non taxation.

This activity is based on the elimination of the tax base elements in such a way that essentially artificial connection points are created, for breaking down the tax base into its different components and to establish them where the greatest tax benefits can be obtained.

The classic example is to artificially search for the generation of deductible expenses for interest payments on investments in a country while for various reasons the income resident in another country is not computed in the tax base: The result is the double advantage from a deductible expense in a jurisdiction with an income that is not taxed in another jurisdiction.

This reality has been shown by international initiatives such as those of the OECD and the European Union, which try to address this issue in a comprehensive way from different perspectives, but considering the need to respond to this situation.

The OECD has created several working groups, involving several of the countries present here, which will report to the fiscal affairs Committee the results of their analysis. The OECD fiscal affairs Committee will adopt an action plan according to these findings.

The European Union has also undertaken the fight against fraud and tax evasion through aggressive tax planning by measures aimed to promote the implementation of minimum standards of good governance in the tax area by third countries. It has also submitted an action plan with a set of measures to reinforce the fight against fraud and tax evasion.

Not only International organizations are addressing this problem. Each of us, in our domestic environment, is suffering the consequences of these abusive and often fraudulent behaviors that undermine our tax bases and, in the current crisis and budgetary austerity context, makes tax fraud more reprehensible than ever.

For that reason, in Spain we have undertaken a reform to keep our legal system in the forefront of the fight against fraud.

But, without being exhaustive, throughout my presentation I'm going to focus on the four most important measures.

The first three are of material nature and the fourth is organizational.

First, the most striking measure has been the regulation to comply with **information on goods and rights located abroad.**

Such obligation has been established in the additional 18th provision of the General tax law (hereinafter LGT), introduced by article 1, section 17 of the law 7/2012: This provision establishes the obligation to file an annual information statement on accounts, securities and real estate located abroad for persons and entities resident in the Spanish territory.

This measure intends to serve as a seal against the fraudster who would receive income from abroad, would not declare it and would wait for the prescription period to put the profits in accounts or assets abroad, out of the scope of information and actions of the Spanish Treasury.

This measure will be reinforced by the tax information that the Administration expects to obtain through bilateral or multilateral instruments of cooperation that are already in force, and the agreement signed with the United States for the application of the FATCA regulations and the improvement of international tax compliance.

The tax information exchange agreements recently signed along with the renegotiation of the exchange of information clause in some old conventions establish the appropriate legal framework for the exchange of tax information which has surged in recent times as

the undisputed protagonist in the fight against harmful tax competition, tax fraud and tax evasion.

Furthermore, the agreement reached with the United States, which will enter into force in the coming months, opens a new perspective by facilitating the information on financial investments by Spanish residents in the United States. At the same time, we are sure that the FATCA initiative will help us to have the same information not only from United States but also from other countries, based on the most-favored-nation clause of the FATCA agreement or on the European Union legislation.

But this does not preclude Spain from strengthening its legislation to avoid the assets relocation problem, either as a result of prior tax fraud or just to prevent the global integration of the income that such assets may produce.

The obligation to report refers to three elements:

1. - Accounts in financial institutions located abroad.
2. - Assets, rights, insurance and income deposited, managed or obtained abroad.
3. - Real estate and rights over immovable property located abroad.

1 Accounts in financial institutions located in foreign countries,

a) Are required to report:

- Individuals and legal entities resident in the Spanish territory, non-residents permanent establishments and entities of art. 35.4 LGT (unsettled estates, community estate, and other bodies which having non-corporate status, make up a separate financial asset unit which is liable to tax)

The obligation will be effective when by December 31 of each year they are:

- Holders or real holders of accounts located abroad (art. 4.2 Law 10/2010),

- Representatives, authorized or beneficiaries or power holders over accounts. This is to avoid the use of proxies allowing hiding the true owner.

This obligation also affects all those who have been holders at some point during the year. This provision seeks to avoid that by December 30 they are dismissed as holders and on January 1 the holder is replaced with the corresponding power.

b) Data to report:

Account identification data: entity, opening or closing date and balance at December 31, and the average balance from the last quarter of the year.

c) Do not have the obligation to report:

- Entities exempt from article 9.1 of the revised Text of the corporate tax law (hereinafter TRLIS) (State, autonomous communities, local entities...)

- Entities and individuals with economic activity having accounts registered individually in their accounting. We are trying to avoid new obligations to those who normally comply; the purpose is to only affect "non-reported" accounts.

- Accounts which balances or their average balance for the last quarter by December 31 do not exceed jointly 50,000 euros. If any of those limits are exceeded, all accounts should be reported. Here the aim is to prevent fraud through numerous accounts with balances less than €50,000. On the other hand, a €50,000 limit prevents from numerous people from having to report accounts abroad, such as for the studies of their children abroad

d) Term for submitting the statement.

Between January 1 and March 31 of the year following the required information

e) Submission of subsequent years

Once the yearly statement is submitted, there is no obligation to report in successive years, except if the joint balances until December 31 (average balances in the past quarter) exceed 20,000 euros increase in regard to those in the last statement.

The report must also be submitted when the holder, representative or authorized person is replaced.

2 Assets, rights, insurance and income deposited, managed or obtained abroad.

a) Are required to declare:

- Individuals and legal entities resident in the Spanish territory, non-residents permanent establishments and entities of art. 35.4 LGT (unsettled estates, community estate, and other bodies which having non-corporate status, make up a separate financial or asset unit that are liable to be taxed)

The obligation will be effective when by December 31 of each year they are:

- Holders or real holders of accounts located abroad (art. 4.2 Law 10/2010),

- Representatives, authorized or beneficiaries or power holders over accounts. This is to avoid the use of proxies allowing hiding the true owner.

This obligation also affects all those who have been holders at some point during the year. This provision seeks to avoid that by December 30 they are dismissed as holders and on January 1 the holder is replaced with the corresponding power.

b) Data to be reported:

Account identification data: entity, opening or closing date and balance at December 31, and the average balance from the last quarter of the year.

c) Do not have the obligation to declare:

- Entities exempt from article 9.1 of the revised Text of the corporate tax law (hereinafter TRLIS) (State, autonomous communities, local entities...)

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d) Term for submitting the statement.

Between January 1 and March 31 of the year following the required information

e) Submission of subsequent years

Once the yearly statement is submitted, there is no obligation to report in successive years, except if the joint balances until December 31 (average balances in the past quarter) exceed 20,000 euros increase in regard to those in the last statement.

A statement must be submitted when the holder is replaced.

3 Real estate and rights over immovable property located abroad.

a) Are required to declare:

- Individuals and legal entities resident in the Spanish territory, non-residents permanent establishments and entities of art. 35.4 LGT (unsettled estates, community estate, and other bodies which having non-corporate status, make up a separate financial or asset unit that are liable to be taxed)

The obligation will be effective when by December 31 of each year they are:

- Holders or real holders of accounts located abroad (art. 4.2 Law 10/2010),

- Representatives, authorized or beneficiaries or power holders over accounts. This is to avoid the use of proxies allowing hiding the true owner.

This obligation also affects all those who have been holders at some point during the year. This provision seeks to avoid that by December 30 they are dismissed as holders and on January 1 the holder is replaced with the corresponding power.

b) Data to be declared:

Account identification data: entity, opening or closing date and balance at December 31, and the average balance from the last quarter of the year.

c) Do not have the obligation to report:

- Entities exempt from article 9.1 of the revised Text of the corporate tax law (hereinafter TRLIS) (State, autonomous communities, local entities...)

- Entities and individuals with economic activity having accounts registered individually in their accounting. We are trying to avoid new obligations to those who normally comply; the purpose is to only affect "non-reported" accounts.

- Accounts which balances or their average balance for the last quarter by December 31 do not exceed jointly 50,000 euros. If any of those limits are exceeded, all accounts should be reported. Here the aim is to prevent fraud through numerous accounts with balances less than €50,000. On the other hand, a €50,000 limit prevents from numerous people from having to report accounts abroad, such as for the studies of their children abroad

d) Term for submitting the statement.

Between January 1 and March 31 of the year following the required information

e) Submission of subsequent years

Once the yearly statement is submitted, there is no obligation to report in successive years, except if the joint balances until December 31 (average balances in the past quarter) exceed 20,000 euros increase in regard to those in the last statement.

The report must also be submitted when the holder is replaced.

But the most relevant modification is not the introduction of a new information obligation but the **effects or consequences established by the law in case the obligation to report is not fulfilled.**

First, the noncompliance to report is a very serious infringement and the penalties are €5,000 for each piece or set of data relating to a non-reported asset or incomplete, inaccurate or false reported data, with a minimum of €10,000. If it is reported out of term without prior notice to the administration, these quantities are reduced to €100 per data or set of data with a minimum of €1,500.

Second consequence: This is the integration of the value of the assets or rights on the income tax of individuals and corporations that should have been reported and was not.

Article 39.2 of the income tax Law establishes that in any case, the tenure, declaration or acquisition of goods or rights that have not fulfilled the obligation of information in the established term shall be considered as unjustified capital gains and the value of such assets or rights will be taxed as an additional element of the general taxable base.

Article 134.6 of the corporate tax law establishes a similar provision that goods and rights not reported by taxpayers in the time limit set for this purpose will be understood as being acquired through unreported income which will fall within the oldest tax period subject to regularization.

Third consequence: This is the offence provided in the income tax for integrating the unjustified gain and in the corporate tax for unreported income from value of the non-reported properties or rights. It is qualified as a very serious tax infringement, and punishable by a proportional fine of 150 percent of the base amount sanction.

The basis of the sanction will be the amount of the total tax without taking into account for its calculation outstanding compensations, deductions or applications from earlier exercises or from the period subject to verification that could lower the taxable base or the total tax.

Second. The second measure refers to **a limitation on the deduction of financial expenses in the corporate profit tax**. This reform places us in line with the legislative trend existing in States within our economic environment.

Limitations on deductions of financial expenses with insufficient economic cause were already applied by the Inspections in cases where this practice was detected. The use of mechanisms or financial schemes that did not respond to economic criteria has been a very common practice in the large companies, using these tactics causing an abusive erosion of tax bases. Notwithstanding that the judgments of the courts of Justice have been favorable to the restrictive interpretation implemented in the tax inspections, it seemed appropriate to line up with other neighboring countries and provide greater legal certainty for taxpayers. This has been done through a regulatory amendment in two ways.

First of all, article 14 of the TRLIS which regulates non-deductible expenses has been modified. An item has been added which states that financial expenses generated within a commercial group, and intended for certain transactions (the purchase of shares in capital stock or own funds of any type of entities to other entities of the group and contributions in capital or own funds to other companies of the Group) between entities from the same group will not be tax-deductible.

This specific rule introduced in the law has two main aspects that I would like to comment.

On one hand, it achieves a greater equality, since until now, only those who had used these tricks and were subject to a review by the tax administration could be subject to correction when the inspection proved that there was not a valid economic reason. This is a disadvantage for those who had been inspected with respect to those who, having done the same thing, had not been inspected yet. Therefore, the amendment provides a normative interpretation of the previous law that had been already implemented by inspection with the courts approval.

On the other hand the rule admits the possibility for those financial expenses to be qualified as deductible expenses but only whenever the taxpayer shows that there are good economic reasons for such operations. In fact, this implies to continue admitting intra-group financing but subject to a reversal burden of proof, since the taxpayer is the one who must now prove that there is a valid economic reason for making such financing. Before, in case of controversy, it was the Administration that had to prove that there was no valid economic reason.

Secondly, there has been a modification in article 20 of the TRLIS, which formerly regulated the sub-capitalization rules, by redrafting it under the statement of limitation on the deductibility of expenses.

The general principle is that the net financial expenses will be deductible with a limit of 30 percent of the operating benefit of the exercise. This limitation becomes, indeed, a specific imputation rule, allowing the deduction of future periods excesses (for the following 18 years). It also sets a threshold that softens the limitation since it states that in any case, net financial expenses from the tax period amounting to EUR 1 million will be deductible.

This measure favors indirect business capitalization and responds, with figures similar to our comparative law, the current tax treatment of financial expenses in the international arena.

The financial expenditure percentage limitation shall not be applied to credit entities or to those which are not part of a group unless they have a direct or indirect participation exceeding 20 per cent.

Third. There is another regulation, with a more internal than international character, but which as a result of fraud in other countries, can also help to prevent money-laundering in Spain. I mean the **limitation of cash payments** established in article 7 of the law 7/2012, October 29.

In accordance to that article, operations in which any of the parties involved act as an entrepreneur or professional may not be paid in cash, for an amount equal to or greater than 2,500 euros or its equivalent in foreign currency.

However, the amount will be 15,000 euros or its equivalent in a foreign currency when the payer is an individual who justifies that he has no fiscal domicile in Spain and does not act as entrepreneur or professional.

Regarding operations which may not be paid in cash, those involved shall keep the payment vouchers for a five years period from the date thereof in order to prove the payment was not done in cash. They also must provide these documents to the State tax administration agency upon request.

To avoid the common fraud consisting in fractioning the payment of operations, the Law requires accumulating all fraction payments from goods or provision of services. The limitation shall apply according to the accumulated amount.

The sanction provided in the rule is 25 per cent of the amount paid and can be required for both the payer as well as for the one who receives such payment.

As I have already mentioned the essential purpose of the rule is to make more difficult the money-laundering or the use of capital irregularly obtained, either in Spain or abroad.

Fourth. The fourth adopted measure by the Spanish tax administration has been organizational and consist in the **creation** of an Office highly specialized in taxation for international operations; **the National Office of International Taxation** will part of the Financial and Tax Inspection Department of the Tax Agency.

The tax agency had already adopted years ago organizational measures to respond to specific challenges as a result of the internationalization of our economy. The two most relevant were the creation of the National Bureau for Fraud Investigation (ONIF in Spanish) and the creation of the Central Unit of Large Taxpayers.

The ONIF includes two special units for international issues within its specialized units.

The first one is the Central information Team which among its activities includes the liaison office, *Central Liaison Office (CLO),* to meet the demands for information derived from agreements to avoid double taxation, as well as the Exchange of Information Agreements and those according to the European law regarding direct taxation, taxation of savings as well as the value-added tax. The requirements of safety and efficiency

deriving from the international information exchange advised to centralize this operational unit in a few specialized bodies that would also assume the internal task to deliver the demands and responses to the competent territorial bodies according to the affected taxpayer.

The second specialized unit was the creation of a team dedicated to the fight against the value added tax fraud within intra-Community transactions (between Member countries of the European Union), which replies to similar units from other countries of the European Union. Their main characteristics for specialized knowledge, national competence, coordination with equivalent units from other Member States of the European Union and the territorial units in Spain have been considered essential for their operation.

On the other hand, the creation of the Central Department for Large Taxpayers was the administrative response in order to give a differentiated treatment to taxpayers who by their size and entity could not be treated by territorial units. It has been a satisfactory experience and the specialization of the integrated units allows the relationship with large taxpayers to be more fluid and effective.

The strong internationalization of the Spanish economy in recent decades has caused the international component to affect, in more cases and in higher amounts, the taxable bases. The international conventions network to avoid double taxation has substantially grown, as well as the rules to be applied in cases where the international component affects the tax base. The Ministry of finance in recent years has made great efforts to improve the staff training about this new reality. Hundreds of officers have taken specialization courses in international taxation. But even with this response, the administration requires additional steps to insert this high specialization in an organizational scheme that would provide a coordinated response from the tax agency to the internationalization of our economy.

In this context, and based on the structures of neighboring countries, on April 1, 2013 the National Office of International Taxation was created, with a nationwide jurisdiction for the management, planning, impulse and operational coordination in the matter, and is a support to other units. It also has a unit of economic and financial appraisals with tax relevance.

The National Office of International Taxation is part of the Financial and Tax Inspection Department of the Tax Agency and reports directly to the Director of the Department.

Currently 30 highly specialized officials are in the office although it is expected that in a short period of time 20 additional officials will be incorporated. Specializing in international taxation, foreign language skills, negotiating skills and coordination ability will be highly valued elements for the Office's staff selection team.

The main activity of the Office is the international related transactions and the analysis of transfer pricing applied, as well as the non-residents taxation.

It should be remembered that in non-resident taxation, the Spanish tax system has a peculiarity that taxes income obtained in Spain from non-residents, whether individuals or companies; it is a separate tax, independent, regulated by law different from the tax law that taxes income from individuals and companies.

We are confident that this organizational change allows the Spanish tax administration to strengthen its effectiveness and its commitment to effectively apply the legislation of international taxation and prevents abuses that erode our tax bases and attempt against free competition between complying companies

I conclude by confirming my belief that the effective response to international taxation challenges may not be faced by each country in an isolated way. The answer is based on three main axes, information, legislation and the application of the rules.

Without information it is impossible to manage taxes and in case of international operations, that information must come from third parties. Tax administrations should support the international initiatives in favor of the information exchange and we should reorganize ourselves for an effective information exchange.

National authorities and international organizations should ensure an appropriate legal framework to tax international operations based on the real possibilities of the involved parties, both taxpayers and administrations.

Tax administrations must organize to implement rules to facilitate voluntary compliance and detect and react against noncompliance, and within the international environment, a balanced and fair cooperation must exist between us