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NEW PROTOCOL AMENDING THE CURRENT US-SPAIN TAX TREATY

On 14 January 2013, the US and Spain concluded a protocol (the "Protocol") amending the tax treaty for the avoidance of double taxation currently in force which was signed on 22 February 1990 (the "Tax Treaty").

The Protocol, when it enters into force, will entail significant improvements in the withholding and tax treatment of certain flows of funds (interest, dividends and capital gains) between residents of both countries.

Key issues

- The Protocol, when it enters into force, will improve the tax treatment of interest, dividends and capital gains, amongst other economic flows
- Following the approval of the Protocol by the United States Senate Committee on Foreign Relations, it will be now submitted to the US Senate for its ratification
- The vote will presumably take place in August

Since that date, the ratification and entry into force of the Protocol has been stalled due to the objections raised by Senator Rand Paul in relation to the information-sharing provision (the Protocol provides for the full exchange of information between the competent tax authorities to facilitate the collection of taxes). In fact, three other protocols (Switzerland, Luxembourg and Japan) and three treaties (Hungary, Chile and Poland) that were also pending approval have been subject to the same objections. Although the clause included in the Protocol is in line with current standards, Senator Rand Paul considered that the information-sharing provisions compromise the privacy of US citizens.

On 25 June 2019, the United States Senate Committee on Foreign Relations approved the Protocol by voice vote (together with the three other pending protocols), rejecting the amendment proposed by Senator Paul (which was intended to raise the standard that the US tax authorities must meet in order to request or share taxpayer information).

The Protocol is now pending final ratification by the US Senate, which will presumably take place in August. If approved, the Protocol will then enter into force within three months following compliance with the relevant US and Spanish domestic procedures for diplomatic notification.

The Protocol includes significant amendments to the current wording of the Tax Treaty which are aimed at improving the tax treatment of reciprocal direct investment. In particular, the main amendments introduced by the Protocol regarding dividends, interests, royalties and capital gains are:

a) **Dividends**: compared to the current wording of the Tax Treaty (which provides for a 10% withholding tax when the company receiving the dividend controls 25% of the voting rights, and 15% in other cases), the Protocol improves the tax treatment of dividends, as it establishes:

i. 0% withholding tax rate if the beneficial owner is a company that directly or indirectly owns shares representing more than 80% of the voting rights, and such shareholder has held the shares in the distributing company for a minimum period of 12 months prior to the distribution;

ii. 5% withholding tax rate if the beneficial owner of the dividends is a company owning 10% or more of the voting rights; and

iii. 15% in all other cases.

b) **Interest**: taxation at source is eliminated (except for the specific provisions applicable to US source contingent interest and loans related to US real estate mortgage conduits).

These new provisions represent a significant change, as US lenders (not acting through a permanent establishment in Spain) will generally not be subject to withholding tax on interest paid by Spanish borrowers as opposed to the current situation where only Banks and other financial institutions enjoyed an exemption in the case of long term (more than five years) loans.

c) **Royalties**: taxation at source on royalties is no longer permitted (except in the case of permanent establishments). This approach will remove a number of bones of contention surrounding the Tax Treaty's current wording in relation to the application of reduced tax treaty rates (specifically, for IT companies, pharmaceutical groups, multinational manufacturing groups, etc.).

d) **Capital gains**: the Protocol establishes no taxation at source on capital gains from the disposal of shares, except in the case of companies holding real estate assets or timeshare rights. Under the current Tax Treaty, gains from the disposal of a qualifying participation (a stake of, at least, 25% during the preceding twelve months) can be taxed.

The Protocol also contains a comprehensive and complex limitation of benefits clause (known as a 'LoB' clause) which, in very general terms, seeks to ensure that only tax residents in the United States of America and the Kingdom of Spain will enjoy the benefits of the Tax Treaty.

As already mentioned, the Protocol is now pending final ratification by the US Senate.

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