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The double taxation convention between Spain and the U.S. -with exemptions for dividend, interest and royalty payments- coming into force on 27 November

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Analysis of the main changes introduced in the new double taxation convention (DTC) between Spain and the United States that will enter into force on 27 November, with special reference to exemptions in relation to dividends, interest and royalties

The Protocol Amending the Convention between the United States of America and the Kingdom of Spain for the Avoidance of Double Taxation, signed in 2013, will finally enter into force on 27 November 2019, three months after the ratification on 27 August of the text in the United States, a procedure that Spain concluded in 2014.

This new text incorporates some important developments that, in general terms, can be summarised as follows:

— Changes are made to general definitions under Article 3 of the Convention, incorporating a "pension fund" definition and a "permanent establishment" related to any building site or construction or installation definition, being the latter currently established as any building site or construction or installation only if it lasts or the activity continues more than 12 months, whereas the previous definition required 6 months.

— The Protocol seeks to make improvements to the mutual agreement procedure, providing, inter alia, for mandatory and binding arbitration - albeit subject to limitations - in disputes not resolved within 2 years, while adapting the clauses providing for the exchange of tax information to the updated OECD Model Tax Convention.

— In relation to dividends, the taxation is substantially improved. Although the general minimum withholding rate is kept at 15% - the only applicable rate when the dividends come from IICs (collective investment schemes) or SOCIMIs (real estate investment stock companies) and, in the case of the latter, only if the share capital held, directly or indirectly, by the beneficial owner of the dividends does not exceed 10% of the total share capital of the SOCIMI in question - this rate is reduced to 5% if the shareholder owns at least 10% of the voting shares of the dividend-paying company.

  Moreover, dividends will be exempt at source if the beneficial owner has held shares representing 80 per cent or more of the voting stocks in the dividend-paying company for a 12-month period prior to the date on which entitlement to the dividends is determined, provided that a series of conditions of the ‘limitation on benefits’ clause – now reworded in Art. 17 on the basis of objective criteria delimiting the personal scope of application (*ratione personae*) and introducing the concept of “qualified person” to benefit from the Convention – are satisfied.

  Nor will dividends be taxed if the beneficial owner is a pension fund exempt from tax or subject to a zero rate of tax, and such dividends are not derived from the carrying on of a trade or business by the pension fund or through an associated enterprise.

— The tax treatment of interest, previously subject to withholding at a reduced rate of 10%, is also improved, except in expressly provided exemption cases. Now, as a general rule, it will be exempt from withholding tax - an exemption which, in view of the Protocol’s reclassification of the income from participating loans, regarding it as interest, determines that it will be taxed only in the State of residence.

  However, two exceptions to this general rule of exemption are provided for. The first relates to contingent interest arising in the United States that do not qualify as portfolio interest under United States law, in which case they may be taxed by the United States, at a rate not exceeding 10 per cent if the beneficial owner is resident in Spain. Nor will interest related to specific products - real estate mortgage conduits - that may be taxed by the United States in accordance with its domestic law be exempt.

— In relation to royalties, the concept of which is simplified, the general rule of exemption at source is also established, so that they will be taxed in the State of residence of the payee.

— With regard to capital gains, the Protocol removes the provision contained in the previous wording of the Convention related to the taxation at source of gains derived from the alienation of shares if the recipient of the gains, during the 12-month period preceding such alienation, had a shareholding of at least 25 percent, adopting now as a general rule the waiver of the taxation at source of gains derived from the alienation of shares. Notwithstanding the foregoing, an additional provision is set forth regarding the possibility to apply the tax at source in respect of profits deriving from the transfer of shares which, directly or indirectly, entitle their owner to the enjoyment of immovable property located in the State of source.

— In addition to all the amendments referred to above, the Protocol makes other important modifications with respect to the previous wording, such as the regulation of the cases in which the benefits of the convention will be applied to transparent entities, or the removal of Article 14 which sets forth an additional tax on branches.

Taking into account that the Protocol will enter into force on 27 November 2019, the text clarifies that its provisions shall take effect: as regards taxes withheld at source, on amounts paid or credited, on or after that date; as regards taxes determined with reference to a taxable period, for taxable periods beginning on or after that date; and as regards mutual agreement procedures, on those cases coming under consideration by the competent authorities on or after said 27 November, date of reference to determine the application of all other cases.

In the following table, the amendments included in the Convention with respect to the different types of income are summarised, comparing the situation before and after the entry into force of the Protocol, which in any case must take into account the provisions of the 'limitation on benefits' clause, clause that determines the Convention's personal scope of application.

Type of income	Situation prior to the adoption of the Protocol	Situation following adoption of the Protocol
Dividends	Applicable withholding tax at source *a*) 10 % if the beneficial owner is a company that owns at least 25 % of the voting shares. *b*) 15 % in all other cases.	Applicable withholding tax at source: *a*) Exempt if the beneficial owner holds at least 80 % of the voting shares and has owned the shares for 12 months *b*) Exempt if the beneficial owner is a pension fund tax exempt or subject to a zero rate of tax[1]. *c*) 5 % if the beneficial owner is a company holding at least 10% of the voting shares. *d*) 15 % in all other cases (IIC and SOCIMI[2]).
Interest	Applicable withholding tax at source: — 10 % in general terms.	Applicable withholding tax at source *a*) Generally exempt[3]. *b*) 10 % in the case of contingent interest or interest related to specific real estate investment products (REMIC).
Royalties	Applicable withholding tax at source: *a*) 5 % for the use of, or the right to use, any copyrights of literary, dramatic, musical or artistic work. *b*) 8 % for the use of, or the right to use, cinematographic films, tapes, etc. *c*) 8 % for the use of, or the right to use, industrial, commercial or scientific equipment, and for any copyright of scientific work. *d*) 10 % in other cases.	Applicable withholding tax at source: — Exempt in general terms.
Capital gains	Applicable withholding tax at source: — 25 % of the gains derived from the alienation of company shares, if the recipient of the gains had a participation in the capital of the company of at least 25% in the previous 12 months.	This provision has been deleted[4].

1 Dividends may not derive from the carrying on of a trade or business by the pension fund or through an associated enterprise.
2 For SOCIMIs, the share capital owned by the beneficial owner of the dividends may not exceed 10% of the total share capital of the SOCIMI in question.
3 This rule shall also apply to interest earned on participating loans.
4 Except where the profits derive from the transfer of shares which, directly or indirectly, entitle their owner to the enjoyment of immovable property situated in the State of source.

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