# NATIONAL FOREIGN TRADE COUNCIL, INC.

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D. Carlos Ocaña
Ministerio de Economía y Hacienda
Secretario de Estado de Hacienda y Presupuestos
Madrid, Spain
Calle Alcalá, 5-7-9

Dear Sr. Ocaña,

The National Foreign Trade Council, organized in 1914, is an association of some 300 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities, and our members have for many years been significant investors in the United Kingdom, where our members have created significant jobs and wealth.

We are writing to you to express our concern over the audit activity by the Spanish Tax Agency of ETVE structures owned by multinational groups. We believe that this activity could significantly affect foreign inward investment in Spain.

As you are aware, the Tax Agency has launched a tax audit program applicable to the Spanish subsidiaries of multinational groups in order to assess the "unpaid" corporate taxes deriving from a perceived "abuse" in the use of these Spanish affiliates as holding companies of other non-Spanish affiliates. Since 2001, these Spanish affiliates have made extensive use of a legal regime known as "ETVE" (Foreign Holding Companies) which at that time was intensively promoted by the Spanish Government among foreign investors.

The Corporate Income Tax Law 43/1995 introduced the ETVE regime with certain restrictions on its use. In 2001, the ETVE regime was modified in order to allow any Spanish resident company to make use of this regime, thus admitting de facto that Spanish source income (active or passive) could be set off by expenses originated by the holding of shares in qualified foreign companies. Additionally, the regime was further enhanced by means of allowing companies which opted for it to be included in Spanish Consolidated Tax units. In 2002, the Spanish law introduced a new feature for investments in holdings of at least 5% in qualified foreign companies, namely the deductibility of the "financial goodwill" depreciation associated to these investments.

As intended by the government, foreign multinationals have made extensive use of the ETVE regime.1 This has been due mainly to the clarity and simplicity of the applicable law, which

1 The official statistics show that in the period 2001-2005 Euro 80 billion of foreign investment in Spain were channelled to ETVE entities.

among other features did not include any kind of restriction which could limit the use of the ETVE-related expenses for sheltering Spanish source income.

Since 2006, however, the Tax Agency has decided to disallow all the financial expenses and "financial goodwill" depreciation incurred by Spanish affiliates to their multinational groups deriving from the acquisition of holdings in other foreign affiliates. The rationale of the Spanish Tax Agency for this position is that the multinational groups are making an abusive use of the Spanish tax regime by means of artificially modifying its group structure, without any real change in the way the group is managed and controlled (i.e. the Spanish acquirer does not effectively manage or control the affiliates it acquires from the group). The lack of substance as perceived by the Spanish Tax Agency leads to the disallowance of the expenses incurred by the Spanish affiliates deriving from the investment in foreign affiliates.

The current scenario is viewed by foreign investors in very negative terms, taking into account that (i) they were encouraged by the Spanish Government to make use of the ETVE regime and the tax consequences of it were very clearly stated in the Law, and (ii) that while there is complete uncertainty about the outcome of the assessments deriving from the current tax audits of ETVE companies, the Government has not modified yet the Corporate tax law in order to stop the perceived abuses. We believe that the ETVE regime has been very favorable for Spain, and has attracted significant foreign capital. Ending it will clearly affect foreign investment. However, the current situation where the law is in place, but no longer respected is even worse. If you do decide that the regime should be ended, then we would ask you to change the law clearly, and, in changing the law, appropriately grandfather all ETVE holding structures entered into before [1 January 2007].

Sincerely yours,

William Reinsch
President