

The verification of tax credits is included in the AEAT's General Tax Control Plan for the 2021 tax year, so they will be one of the many inspection objectives this year. In this regard, the Spanish Tax Authorities has just published a note with questions about application of the International Tax Credit in which it deals with some criteria for its calculation and application.

The Corporate Income Tax Law establishes that when the tax base of the taxpayer includes positive income obtained and taxed abroad, the lesser of the following two amounts will be deducted from the gross tax payable:

- the tax paid abroad on account of an identical/analogous tax to the Spanish Corporate Income Tax;
- the tax that would be payable in Spain if the income would had been obtained in Spanish territory.

Requirements for the implementation of the International Tax Credit:

1. Need for proof of actual payment of withholding tax in the other State:

The AEAT clarifies that it is the taxpayer who must justify the payment of the withholding tax in the State of the source, using the means of proof that the taxpayer considers appropriate (a certificate issued by the Tax Administration of the withholding tax State is usually accepted).

2. The withholding tax required in the other State must be that which arises from the Double Tax Convention between the two countries:

Spain will never allow the deduction of a withholding tax in excess of that established in the Double Tax Convention, so that, in the event that the withholding tax applied abroad is higher, the Spanish company will have to demand the refund of the excess withholding tax in the withholding tax State. This can be a source of conflict since both States could differ in the qualification of the income and, therefore, in the article of the Double Tax Convention that is applicable to establish the withholding tax limit (it could even happen that Spain considers such income as business profit and, therefore, not subject to withholding tax in the withholding tax State, while the withholding tax State might not consider such income as business profit. In this case, the AEAT would not allow the application of the International Tax Credit in Spain, considering that it was not correctly taxed in the withholding tax State, regardless of the Spanish company's right to challenge the tax adjustment).

3. Application of the deduction limit:

Under Corporate Income Tax rules, the lesser of two amounts can be deducted as International Tax Credit:

- the tax paid abroad on account of an identical/analogous tax to the Spanish Corporate Income Tax;
- the tax that would be payable in Spain if the income would had been obtained in Spanish territory.

In order to calculate the full tax payable in Spain, the net income obtained in the other State must be taken into account (i.e. gross income minus all associated expenses, including direct and indirect expenses, in Spain or in the withholding tax State). The judgments of the Supreme Court of 14-6-2013 (rec. 1256/2011) and of the Audiencia Nacional of 26-12-2013, Rec. 109/2011, have ruled along these lines.

By way of example:

A company has an income in Brazil of 1,000 which is qualified as a royalty. Brazil withholds 15% (150). The company provides proof of the income of 150 to the Brazilian Tax Authorities.

In Spain, the company declares a Taxable Base of 200, as it has expenses of 800. The rate is 30%. Total tax of 60.

International Tax Credit shall be the lesser of:

- a. Tax payable in Brazil: 250 (25% of 1,000). (*)
- b. Tax payable in Spain: 60.

CORRECT International Tax Credit: 60

(*) by virtue of the most favoured nation clause provided for in the Protocol to the Double Tax Convention with Brazil, the withholding tax rate of 10% is always applicable and not 15% (also provided for in Article 12 of the Double Tax Convention). However, for the purposes of deduction, a tax rate of 25% is considered to have been paid in Brazil (Art. 23.2 of the Double Tax Convention with Brazil).

4. Deductibility of input tax in the other State is not a deductible expense in Spain

If the tax paid abroad has been accounted in Spain as an expense, it would be considered non-deductible for Corporate Income Tax purposes.

The excess of the tax paid abroad that does not form part of the tax credit (because it exceeds the deduction limit indicated in section 3) above) is allowed as a deductible expense for Corporate Income Tax purposes, provided that it corresponds to the performance of economic activities abroad (in this respect, the Spanish Tax Authorities has issued the tax ruling V3960-16).

However, this deductibility of the expense does not apply if the withholding tax applied abroad to the Spanish company does not correspond to that established by the Double Tax Convention, as indicated in section 2) above (in this regard, the Spanish Tax Authorities has issued the tax ruling V1637-16).