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In this article, the authors provide flowcharts to assist practitioners in determining whether companies are eligible for benefits under the limitation on benefits provision in the Spain-U.S. income tax treaty.

To be entitled to benefits under income tax treaties, companies must satisfy specific eligibility requirements. This article includes decision-making flowcharts to assist taxpayers and tax practitioners in navigating the eligibility requirements of the Spain-U.S. income tax treaty[1] (hereinafter, the "treaty") as applied to Spanish companies, with a particular focus on the eligibility requirements for a 0 percent withholding tax rate on dividends. The flowcharts in this article specifically involve amendments to the treaty made by a protocol that the parties signed on January 14, 2013, and that entered into force on November 27, 2019 (hereinafter, the "2013 protocol").

Income tax treaties may exempt business income from source country income taxes and eliminate or reduce domestic withholding taxes on specified payments between residents of countries that are parties to the treaty. To be entitled to benefits under a U.S. income tax treaty, a company generally must not only be a resident of the tax treaty partner's country, but it must also satisfy at least one of the tests required by an applicable limitation on benefits provision.

The flowcharts in this article focus on the eligibility of Spanish companies claiming treaty benefits under the treaty's LOB article (article 17) on income that would otherwise be subject to U.S. federal income taxation. This article does not address the eligibility for treaty benefits of entities that are partnerships or otherwise transparent for U.S. or Spanish tax purposes. This article is based on the treaty, the 2013 protocol, the memorandum of understanding to the 2013 protocol, and the U.S. Treasury Department's technical explanation of the 2013 protocol.

This article also addresses the eligibility of Spanish companies for the 0 percent withholding

[1] "Convention Between the United States of America and the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income," signed on Feb. 22, 1990, and accompanying protocol signed on Jan. 14, 2013.

tax rate on dividends under article 10.3 and the LOB provision of the treaty.

This article contains nine flowcharts that analyze the LOB provision of the treaty as applied to Spanish resident companies. These flowcharts may serve as a useful practice tool for taxpayers and tax practitioners. Although the flowcharts provide a comprehensive review of applicable provisions under the treaty, taxpayers and their tax advisers should carefully evaluate each individual case and determine whether the requirements of the treaty are met based on all facts and circumstances.

This article is the 18th in a series of articles[2] that provide flowcharts to assist taxpayers and tax practitioners in determining a company's eligibility for tax treaty benefits under the LOB provisions of specific U.S. income tax treaties and, when applicable, in determining eligibility for a 0 percent withholding tax rate on cross-border intercompany dividend payments to the company.[3]

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[2] *See* Jason Connery, Ron Dabrowski, and Jennifer Blasdel-Marinescu, "Eligibility for Treaty Benefits Under the Finland-U.S. Income Tax Treaty," *Tax Notes Int'l*, Oct. 21, 2019, p. 245; Connery, Dabrowski, and Blasdel-Marinescu, "Eligibility for Treaty Benefits Under the New Zealand-U.S. Income Tax Treaty," *Tax Notes Int'l*, July 31, 2017, p. 465; Connery, Dabrowski, and Blasdel-Marinescu, "Eligibility for Treaty Benefits Under the Mexico-U.S. Income Tax Treaty," *Tax Notes Int'l*, June 27, 2016, p. 1285; Connery, Dabrowski, and Blasdel-Marinescu, "Eligibility for Treaty Benefits Under the Denmark-U.S. Income Tax Treaty," *Tax Notes Int'l*, June 29, 2015, p. 1219; Connery and Blasdel-Marinescu, "Eligibility for Treaty Benefits Under the Belgium-U.S. Income Tax Treaty," *Tax Notes Int'l*, Feb. 10, 2014, p. 563; Connery and Blasdel-Marinescu, "Eligibility for Treaty Benefits Under the Ireland-U.S. Income Tax Treaty," *Tax Notes Int'l*, June 17, 2013, p. 1223; Connery, Douglas Poms, and Blasdel-Marinescu, "Eligibility for Treaty Benefits Under the Sweden-U.S. Income Tax Treaty," *Tax Notes Int'l*, July 23, 2012, p. 359; Connery, Poms, and Blasdel-Marinescu, "Eligibility for Treaty Benefits Under the Australia-U.S. Income Tax Treaty," *Tax Notes Int'l*, Dec. 12, 2011, p. 843; Connery, Poms, and Blasdel, "Eligibility for Treaty Benefits Under the Switzerland-U.S. Income Tax Treaty," *Tax Notes Int'l*, May 9, 2011, p. 505; Connery, Poms, and Blasdel, "Eligibility for Treaty Benefits Under the Japan-U.S. Income Tax Treaty," *Tax Notes Int'l*, Sept. 6, 2010, p. 789; Connery, Poms, and Blasdel, "Eligibility for Treaty Benefits Under the 2009 Protocol to the France-U.S. Income Tax Treaty," *Tax Notes Int'l*, Apr. 12, 2010, p. 149; John Venuti, Connery, Poms, and Blasdel, "Eligibility for Treaty Benefits Under the Netherlands-U.S. Income Tax Treaty," *Tax Notes Int'l*, Nov. 23, 2009, p. 601; Venuti, Connery, Poms, and Alexey Manasuev, "Eligibility for Treaty Benefits Under the Canada-U.S. Income Tax Treaty," *Tax Notes Int'l*, June 15, 2009, p. 967; Venuti, Dabrowski, Poms, and Manasuev, "Eligibility for Treaty Benefits Under U.K.-U.S. Income Tax Treaty," *Tax Notes Int'l*, Mar. 23, 2009, p. 1095; Venuti, Connery, Poms, and Manasuev, "Eligibility for Treaty Benefits Under the Luxembourg-U.S. Income Tax Treaty," *Tax Notes Int'l*, July 21, 2008, p. 285; Venuti, Dabrowski, Poms, and Manasuev, "Eligibility for Treaty Benefits Under the France-U.S. Income Tax Treaty," *Tax Notes Int'l*, Feb. 11, 2008, p. 523; and Venuti and Manasuev, "Eligibility for Zero Withholding on Dividends in the New Germany-U.S. Protocol," *Tax Notes Int'l*, Jan. 14, 2008, p. 181.

[3] The information in this article is not intended as "written advice concerning one or more federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230; the content is issued for general informational purposes only. The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only and does not necessarily represent the views or professional advice of KPMG LLP.

Chart 1. Eligibility for Treaty Benefits Under Article 17 (LOB) of the Spain-U.S. Tax Treaty

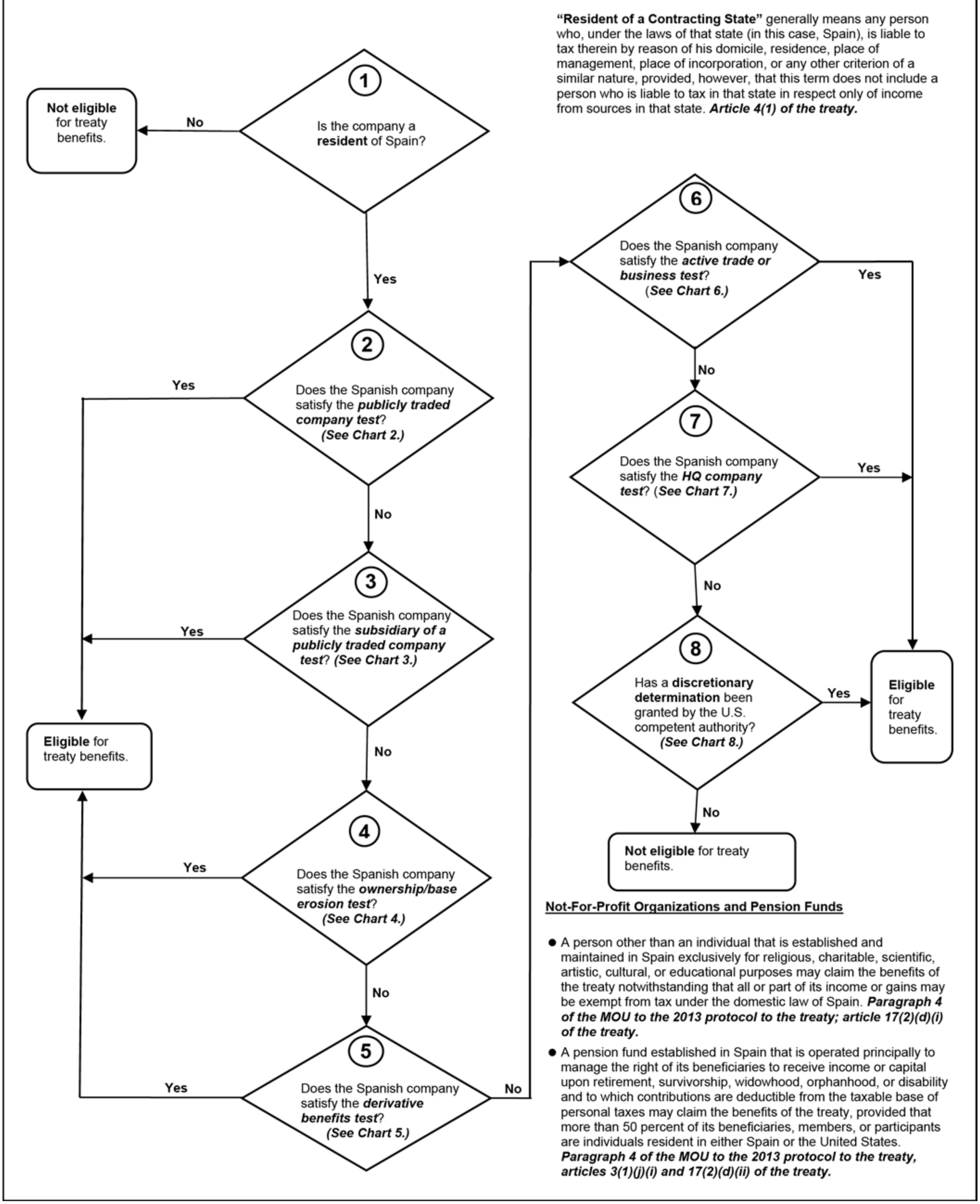
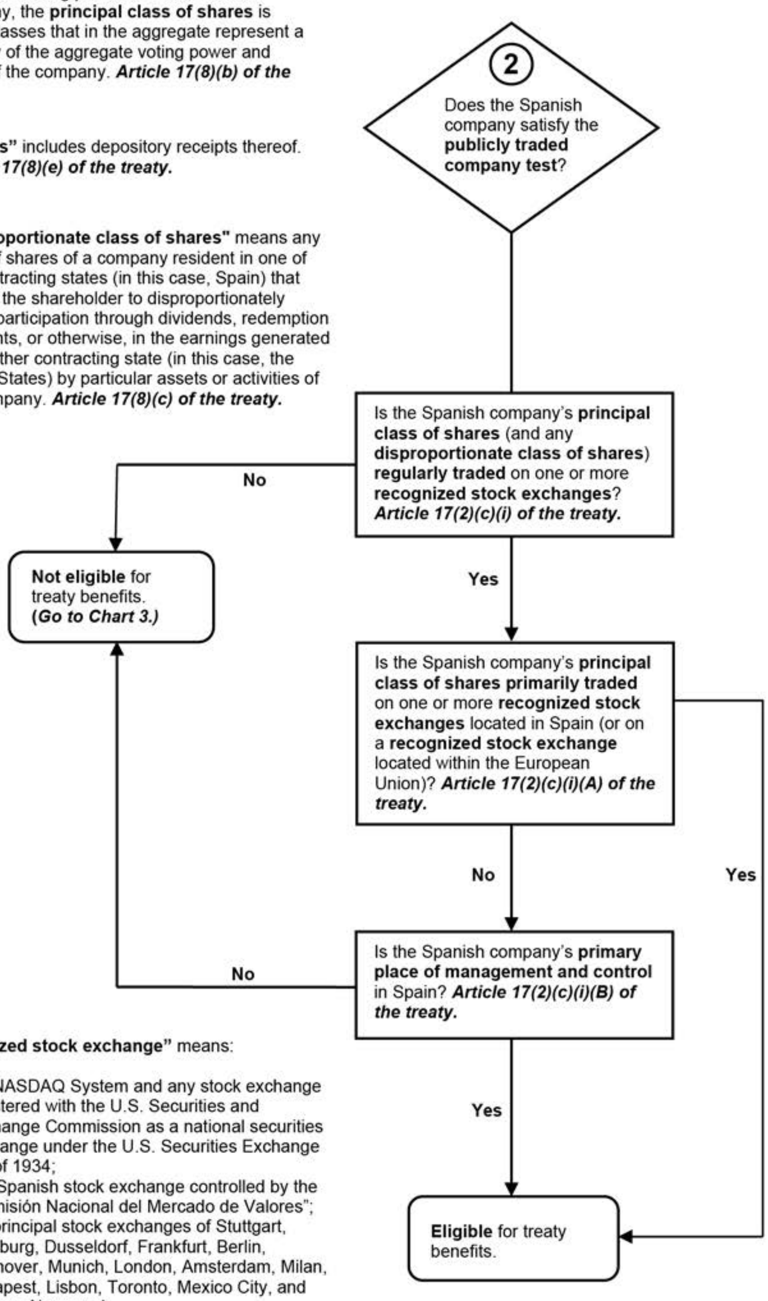


Chart 2. Publicly Traded Company Test Under Article 17(2)(c)(i) (LOB) of the Spain-U.S. Tax Treaty

"Principal class of shares" means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the **principal class of shares** is those classes that in the aggregate represent a majority of the aggregate voting power and value of the company. ***Article 17(8)(b) of the treaty.***

"Shares" includes depository receipts thereof. ***Article 17(8)(e) of the treaty.***

"Disproportionate class of shares" means any class of shares of a company resident in one of the contracting states (in this case, Spain) that entitles the shareholder to disproportionately higher participation through dividends, redemption payments, or otherwise, in the earnings generated in the other contracting state (in this case, the United States) by particular assets or activities of the company. ***Article 17(8)(c) of the treaty.***



"Recognized stock exchange" means:

(i) the NASDAQ System and any stock exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934;
(ii) any Spanish stock exchange controlled by the "Comisión Nacional del Mercado de Valores";
(iii) the principal stock exchanges of Stuttgart, Hamburg, Dusseldorf, Frankfurt, Berlin, Hannover, Munich, London, Amsterdam, Milan, Budapest, Lisbon, Toronto, Mexico City, and Buenos Aires; and
(iv) any other stock exchange agreed upon by the competent authorities.

Article 17(8)(a) of the treaty.

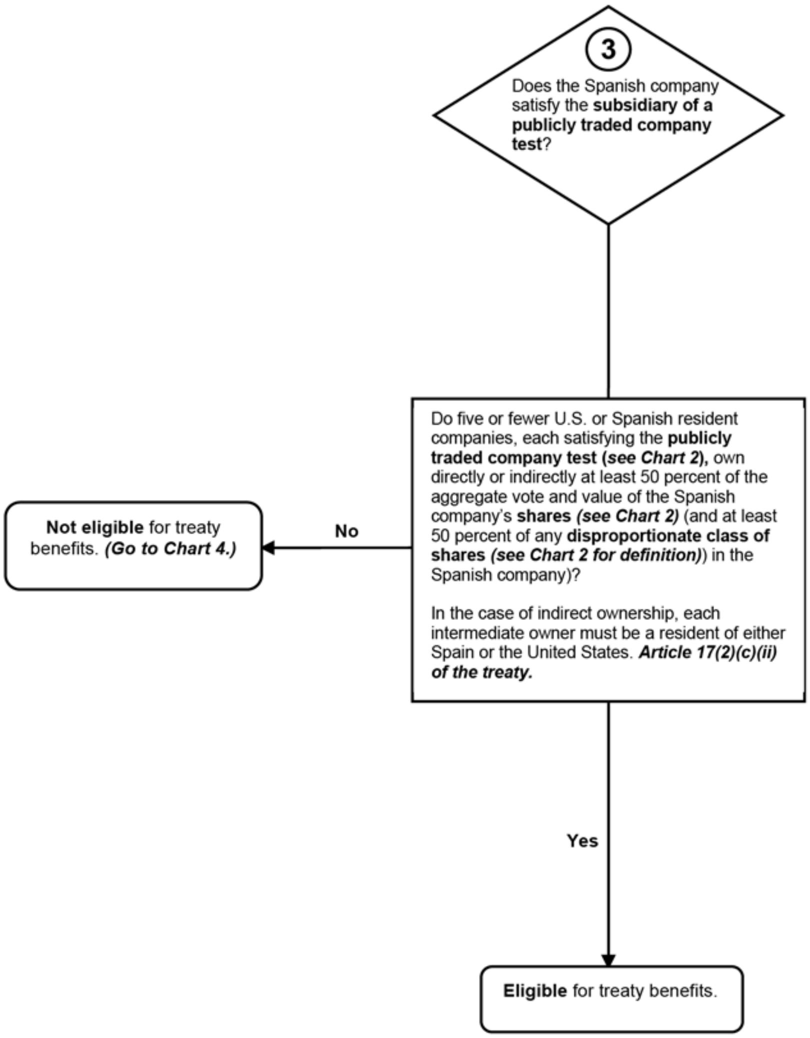
A class of shares comprising the principal class of shares is considered to be "**regularly traded"** on one or more **recognized stock exchanges** in a taxable year if the following two conditions are met: (i) trades in the class of shares are made in more than de minimis quantities on at least 60 days during the taxable year; and (ii) the aggregate number of shares in the class traded during the year is at least 10 percent of the average number of shares outstanding during the year. The **regularly traded** requirement can be met by trading on any **recognized exchange or exchanges** located in either Spain or the United States. Trading on one or more **recognized stock exchanges** may be aggregated for purposes of the **regularly traded** requirement. Authorized but unissued shares are not considered for purposes of this test. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

Stock of a Spanish company is **"primarily traded"** if the number of **shares** in the company's **principal class of shares** that are traded during the taxable year on all **recognized stock exchanges** in Spain exceeds the number of shares in the company's **principal class of shares** that are traded during the year on established securities markets in any other single foreign country. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

A Spanish company's **primary place of management and control** is in Spain only if executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial, and operational policy decision making for the company (including its direct and indirect subsidiaries, if any) in Spain than in any other state and the staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions in Spain than in any other state. ***Article 17(8)(d) of the treaty.*** Thus, the **primary place of management and control test** looks to the overall activities of the relevant persons to see where those activities are conducted. In most cases, it will be a necessary, but not a sufficient, condition that the headquarters of the company (that is, the place at which the chief executive officer and other top executives normally are based) be located in Spain. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

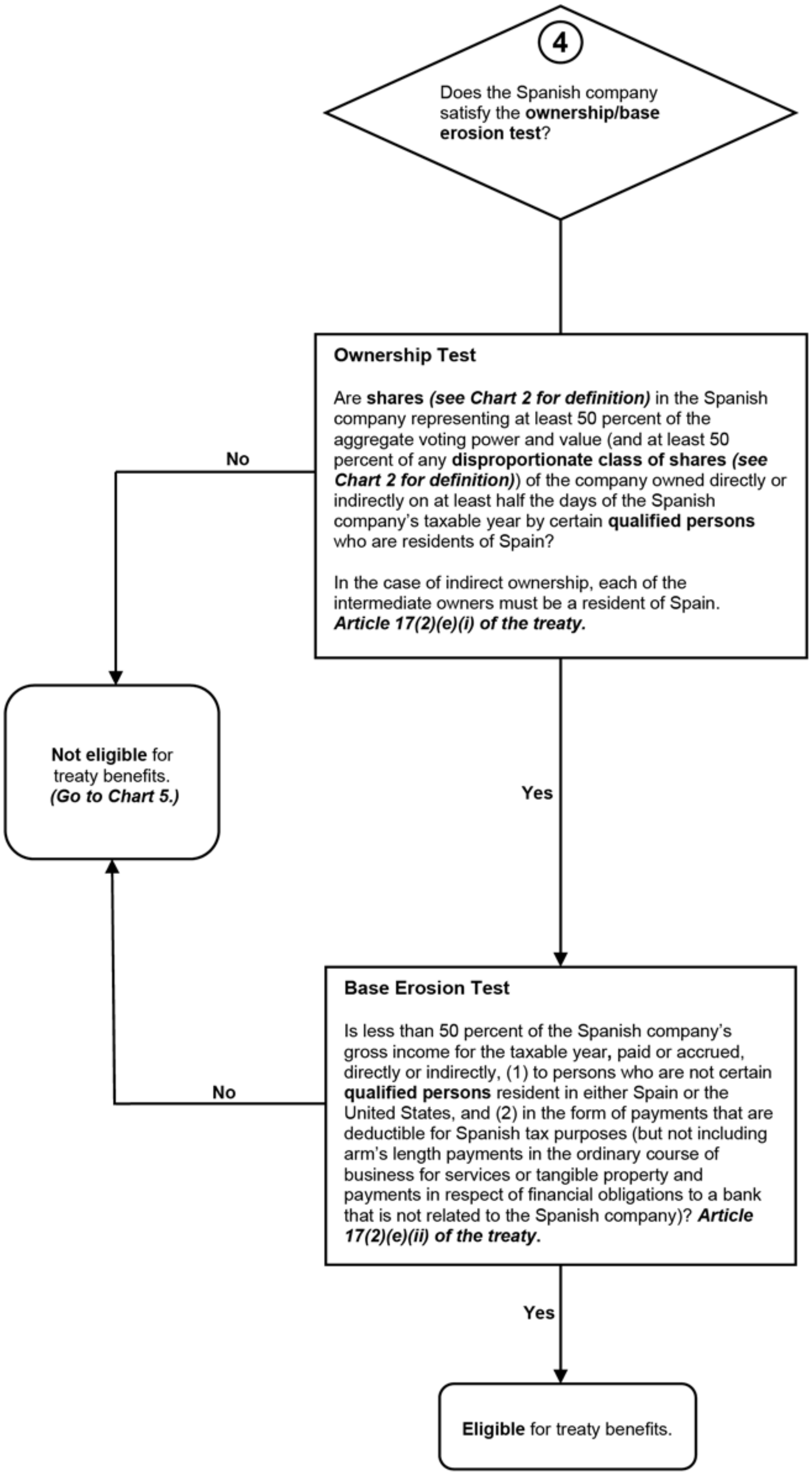
To apply the **primary place of management and control test,** it is necessary to determine which persons are to be considered "executive officers and senior management employees". In most cases, it will not be necessary to look beyond the executives who are members of the board of directors (the "inside directors") in the case of a U.S. company. That will not always be the case, however; in fact, the relevant persons may be employees of subsidiaries if those persons make the strategic, financial, and operations policy decisions. Moreover, it would be necessary to take into account any special voting arrangements that result in certain board members making certain decisions without the participation of other board members. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

Chart 3. Subsidiary of a Publicly Traded Company Test Under Article 17(2)(c)(ii) (LOB) of the Spain-U.S. Tax Treaty



Example
A Spanish resident company, all the shares of which are owned by another Spanish resident company, would qualify for benefits under the treaty if the **principal class of shares *(see Chart 2 for definition)*** (and any **disproportionate classes of shares *(see Chart 2 for definition)***) of the Spanish parent company are **regularly traded** and **primarily traded *(see Chart 2 for definitions)*** on a **recognized stock exchange *(see Chart 2 for definition)*** in Spain (or within the European Union). However, such a Spanish resident subsidiary would not qualify for benefits under the **subsidiary of a publicly traded company test** if the publicly traded parent company were a resident of a third state, for example, and not a resident of the United States or Spain. Furthermore, if a Spanish parent company indirectly owned the bottom-tier company through a chain of subsidiaries, each such subsidiary in the chain, as an intermediate owner, must be a resident of the United States or Spain in order for the subsidiary to meet the **subsidiary of a publicly traded company test**. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

Chart 4. Ownership/Base Erosion Test Under Article 17(2)(e) (LOB) of the Spain-U.S. Tax Treaty



Qualified persons for purposes of the **Ownership Test** are limited to residents of Spain that are:

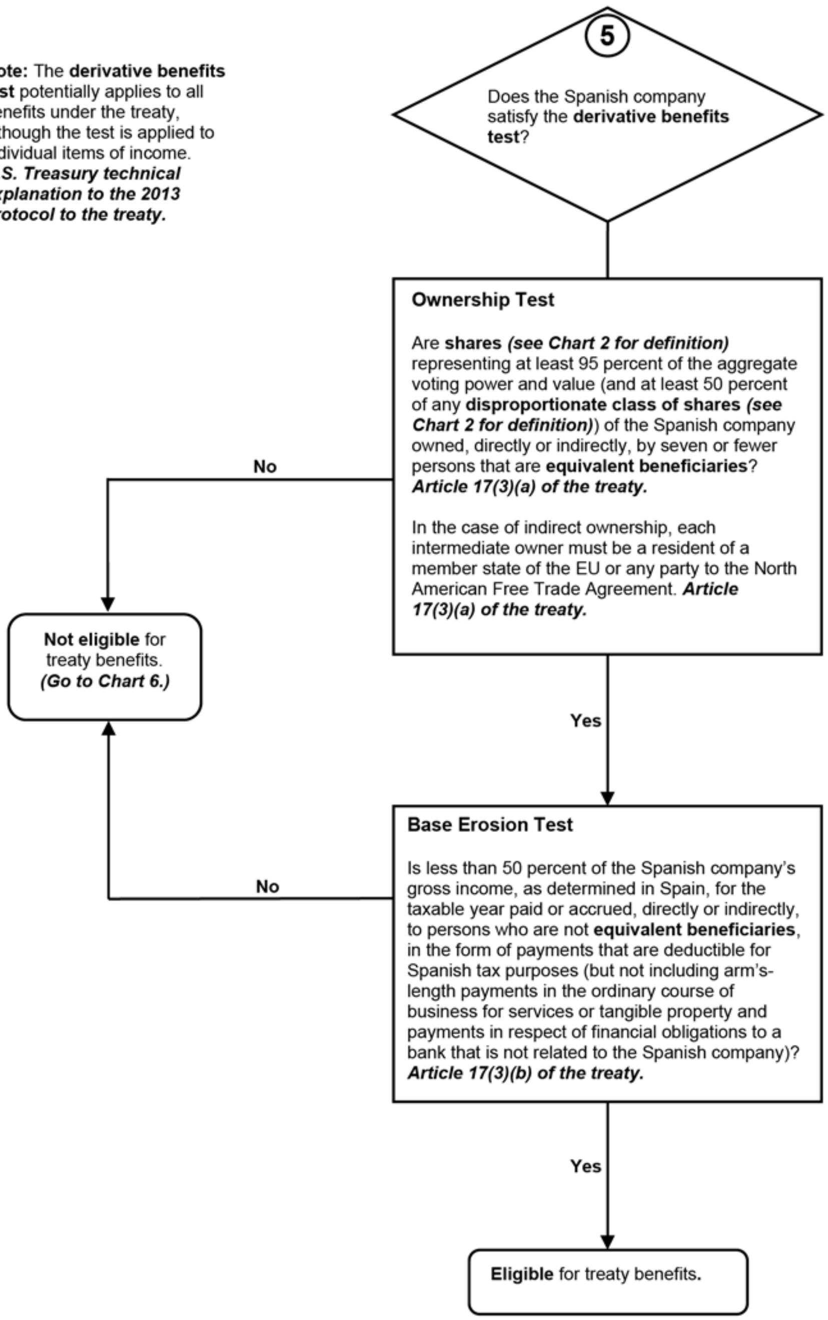
A. individuals resident in Spain ***(see article 17(2)(a) of the treaty)***;
B. Spain, or a political subdivision or local authority thereof or wholly-owned instrumentality thereof ***(see article 17(2)(b) of the treaty)***;
C. Spanish companies that satisfy the **publicly traded company test** ***(see Chart 2) (see article 17(2)(c)(i) of the treaty)***; and
D. certain Spanish resident pension trusts and not-for-profit organizations organized in Spain ***(see article 17(2)(d) of the treaty)***.

Qualified persons for purposes of the **Base Erosion Test** are those described in A, B, C, and D, above, and corresponding U.S. residents.

For purposes of the **Base Erosion Test**, depreciation and amortization deductions, which do not represent payments or accruals to other persons, are disregarded. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

Chart 5. Derivative Benefits Test Under Article 17(3) (LOB) of the Spain-U.S. Tax Treaty

Note: The **derivative benefits test** potentially applies to all benefits under the treaty, although the test is applied to individual items of income. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***



"Equivalent Beneficiary" means:

A resident of a member state of the EU or of a party to the NAFTA, but only if that resident:

(i)(A) would be entitled to ***all*** the benefits of a comprehensive income tax treaty between any member state of the EU or any party to NAFTA and the United States under provisions analogous to the rules for certain **qualified persons** ***(see Chart 4, Base Erosion Test, for definition)***, provided that if the treaty does not contain a comprehensive LOB article, the person would be entitled to the benefits of the Treaty by reason of status as a **qualified person** ***(see Chart 4, Base Erosion Test, for definition)*** if the person were a resident of one of the states under article 4 (residence) of the treaty; **and**

(B) with respect to insurance premiums and to income referred to in articles 10 (dividends), 11 (interest), and 12 (royalties) of the treaty, would be entitled under the treaty to an exemption from excise tax on such premiums or to a rate of tax with respect to the particular class of income for which benefits are being claimed under the treaty that is at least as low as the rate applicable under the treaty; **or**

(ii) is a resident of either the United States or Spain that is a **qualified person** ***(see Chart 4, Base Erosion Test, for definition)*** entitled to the benefits of the treaty by reason of such status. ***Article 17(8)(g) of the treaty.***

Note: For purposes of applying paragraph 3 of article 10 (dividends) of the treaty, in order to determine whether a person owning shares, directly or indirectly, in the company claiming the benefits of the treaty is an **equivalent beneficiary**, such person shall be deemed to hold the same voting power, for the same period of time, in the company paying the dividend as the company claiming the benefits holds in such company. ***Article 17(8)(g), flush language, of the treaty.***

Note: Under article 17(7)(g)(i), a company that satisfies the **subsidiary of a publicly traded company test** ***(see Chart 3)*** or the **ownership/base erosion test** ***(see Chart 4)*** is ***not*** an **equivalent beneficiary.**

Chart 6. Active Trade or Business Test Under Article 17(4) (LOB) of the Spain-U.S. Tax Treaty

(Applies only if an item of income is derived in connection with or incidental to active trade or business in Spain)

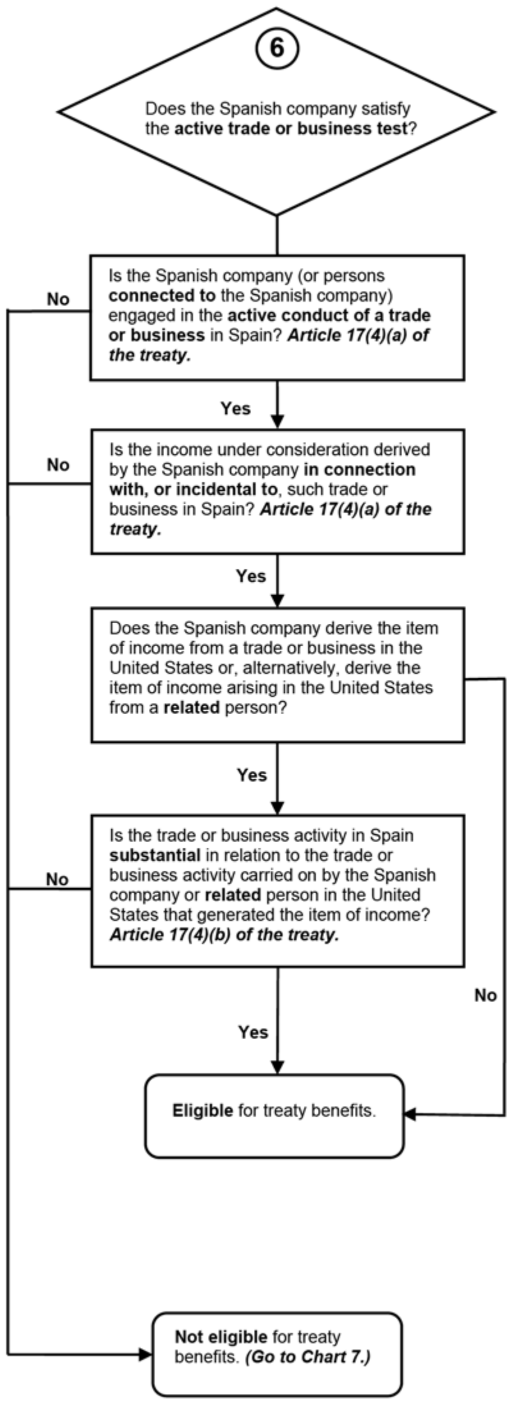
An item of income is derived **"in connection with"** a trade or business if the income-producing activity in the source state (in this case, the United States) is a line of business that "forms a part of" or is "complementary" to the trade or business conducted in Spain by the income recipient. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

A business activity generally will be considered to **"form a part of"** a business activity conducted in the source state if the two activities involve the design, manufacture, or sale of the same products or type of products, or the provision of similar services. The line of business in the state of residence may be upstream, downstream, or parallel to the activity conducted in the source state. Thus, the line of business may provide inputs for a manufacturing process that occurs in the source state, may sell the output of that manufacturing process, or simply may sell the same sorts of products that are being sold by the trade or business carried on in the source state. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

For two activities to be considered to be **"complementary,"** the activities need not relate to the same types of products or services, but they should be part of the same overall industry and be related in the sense that the success or failure of one activity will tend to result in success or failure for the other. When more than one trade or business is conducted in the source state and only one of the trades or businesses forms a part of or is complementary to a trade or business conducted in the state of residence, it is necessary to identify the trade or business to which an item of income is attributable. Royalties generally will be considered to be derived in connection with the trade or business to which the underlying intangible property is attributable. Dividends will be deemed to be derived first out of earnings and profits of the treaty-benefited trade or business, and then out of other earnings and profits. Interest income may be allocated under any reasonable method consistently applied. A method that conforms to U.S. principles for expense allocation will be considered a reasonable method. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

An item of income derived from the source state (in this case, the United States) is **"incidental to"** the **trade or business** carried on in Spain if production of the item facilitates the conduct of the **trade or business** in Spain. An example of incidental income is the temporary investment of working capital of a person in Spain in securities issued by persons in the source State. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

It is understood that a person shall be deemed to be **related** to another person if either person participates directly or indirectly in the management, control, or capital of the other, or the same persons participate directly or indirectly in the management, control, or capital of both. ***Paragraph 5 of the MOU to the 2013 protocol to the treaty.***



The term **"trade or business"** is not defined in the Treaty. The **U.S. Treasury technical explanation to the 2013 protocol to the treaty** explains that the United States will refer to the regulations issued under section 367(a) (repealed) for the definition of the term **"trade or business."** In general, therefore, a **trade or business** will be considered to be a specific unified group of activities that constitute or could constitute an independent economic enterprise carried on for profit. Furthermore, a corporation generally will be considered to carry on a trade or business only if the officers and employees of the corporation conduct substantial managerial and operational activities. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

The **active conduct of a trade or business** does not include the business of making or managing investments for one's own account, unless these activities are banking, insurance, or securities activities carried on by a bank, insurance company, or registered securities dealer, respectively. ***Article 17(4)(a) of the treaty.*** Because a headquarters operation is in the business of managing investments, a company that functions solely as a headquarters company will not be considered to be engaged in an **active trade or business** for purposes of the **active trade or business test. *U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

In determining whether a person satisfies the **active trade or business test**, activities conducted by persons **connected to** that person shall be deemed to be conducted by that person. A person shall be **"connected to"** another if one possesses at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company's **shares *(see Chart 2 for definition)*** or of the beneficial equity interest in the company) or another person possesses at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate vote and value of the company's **shares *(see Chart 2 for definition)*** or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be **connected to** another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons. ***Article 17(4)(c) of the treaty.***

Whether the Spanish company's **trade or business** (or the **trade or business** of a person **connected to** the Spanish company) is **substantial** in relation to the **trade or business** activity in the United States that generated the item of income is determined based upon all the facts and circumstances and takes into account: (i) the comparative sizes of the **trades or businesses** in each contracting state; (ii) the nature of the activities performed in each contracting state; and (iii) the relative contributions made to that **trade or business** in each contracting state. In any case, in making each determination or comparison, due regard will be given to the relative sizes of the U.S. and Spanish economies. The determination of **substantiality** is made separately for each item of income derived from the source state. It therefore is possible that a person would be entitled to the benefits of the treaty with respect to one item of income but not with respect to another. If a resident of a contracting state is entitled to treaty benefits with respect to a particular item of income under the **active trade or business test**, the resident is entitled to all benefits of the treaty insofar as they affect the taxation of that item of income in the source state. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

Chart 7. Headquarters Company Test Under Article 17(5) (LOB) of the Spain-U.S. Tax Treaty

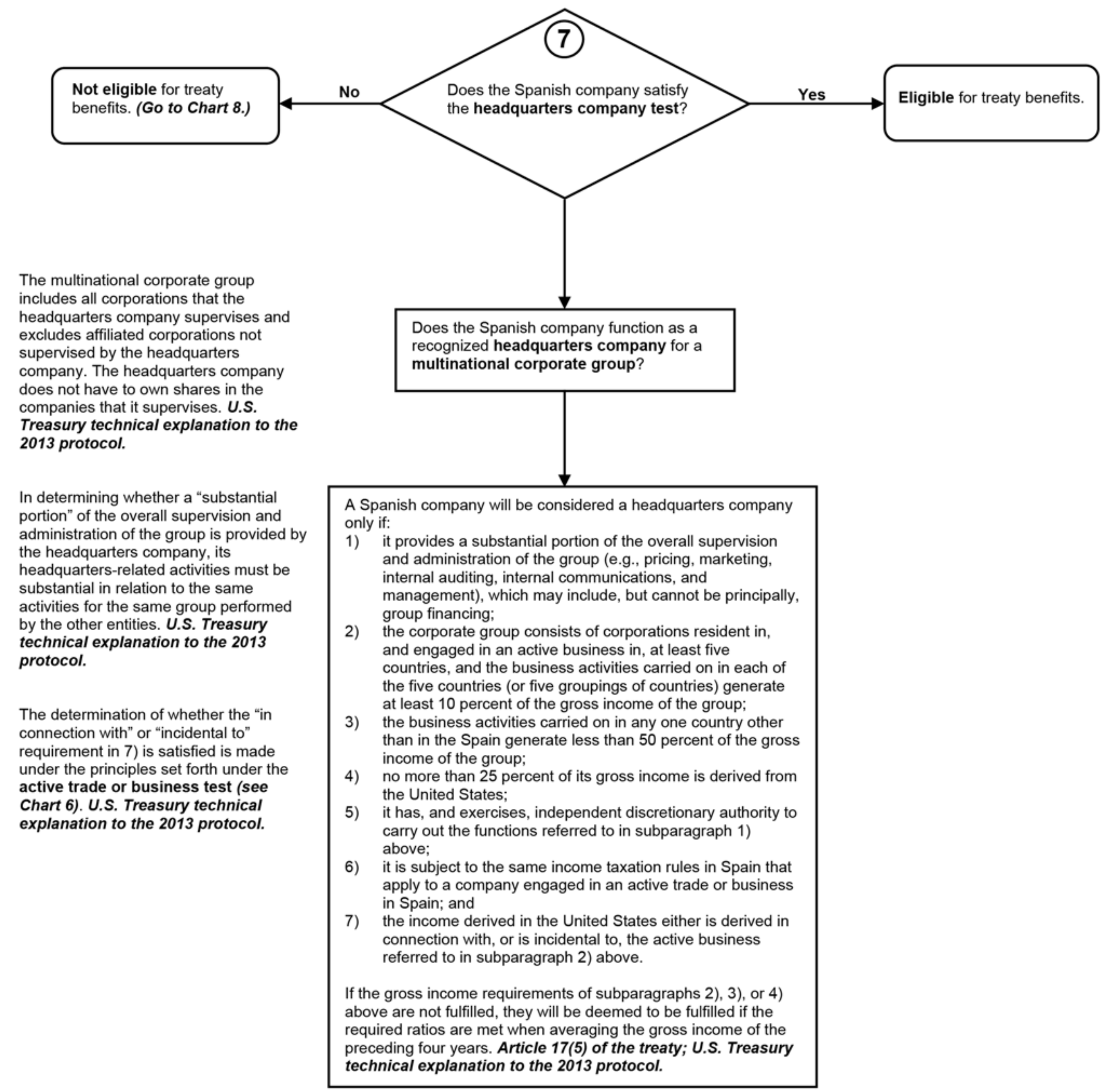


Chart 8. Discretionary Determination by U.S. Competent Authority Under Article 17(7) (LOB) of the Spain-U.S. Tax Treaty

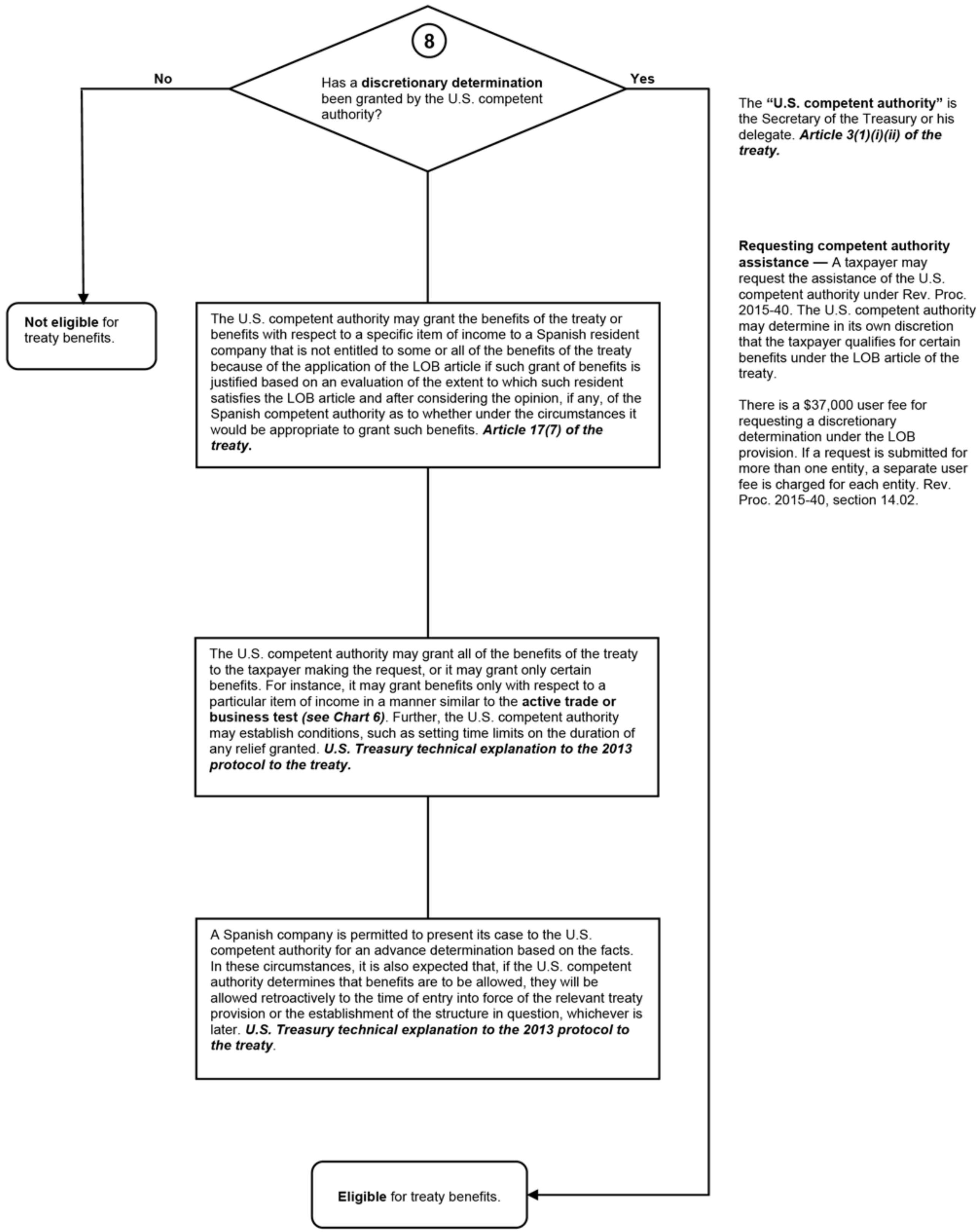


Chart 9. Eligibility for Zero Percent Withholding Tax Rate on Dividend Under Article 10(3) of the Spain-U.S. Tax Treaty

9

Is the Spanish company the **beneficial owner** of **dividends** from U.S. sources?

No → Not eligible

Yes

Has the Spanish company owned, **directly or indirectly** through one or more residents of either the United States or Spain, **shares** ***(see Chart 2 for definition)*** representing 80 percent or more of the voting power in the company paying the dividends for a 12-month period ending on the date on which entitlement to the dividends is determined? ***Article 10(3) of the treaty.***

No → Not eligible

Yes

Is one of the following satisfied:

1) the Spanish company satisfies either the **publicly traded company test** ***(see Chart 2)*** or the **subsidiary of a publicly traded company test** ***(see Chart 3)***;

2) the Spanish company satisfies the **ownership/base erosion test** ***(see Chart 4)*** and, with respect to such dividends, the **active trade or business test** ***(see Chart 6);***

3) the Spanish company is entitled to benefits with respect to such dividends under the **derivative benefits test** ***(see Chart 5)***; ***or***

4) the Spanish company obtained a **discretionary determination** ***(see Chart 7)*** from the U.S. competent authority providing for a zero percent withholding tax rate on **dividends**?

No → Not eligible

Yes

Eligible to claim zero percent withholding tax rate on dividends.

Not eligible to claim zero percent withholding tax rate on dividends.

The **"beneficial owner"** of a **dividend** is the person to which the **dividend** income is attributable under the laws of the source state (in this case, the United States). Thus, if a **dividend** paid by a corporation that is a resident of one of the states (in this case, the United States) is received by a nominee or agent that is a resident of the other state (in this case, Spain) on behalf of a person that is not a resident of that other state (in this case, not a resident of Spain), the **dividend** is not entitled to the benefits of article 10(3). However, a **dividend** received by a nominee on behalf of a resident of that other state (in this case, Spain) would be entitled to benefits. ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

The term **"dividends"** means:

(i) income from **shares** ***(see Chart 2 for definition)***, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits; and

(ii) income that is subjected to the same taxation treatment as income from shares by the laws of the state of which the company making the distribution is a resident (in this case, the United States); ***article 10(5) of the treaty.***

The treaty defines the term **"dividends"** broadly and flexibly. The definition is intended to cover all arrangements that yield a return on an equity investment in a corporation as determined under the tax law of the source state (in this case, the United States), as well as arrangements that might be developed in the future. The term includes income that is subjected to the same tax treatment as income from shares by the law of the source state, including amounts treated as dividend equivalents under Internal Revenue Code of 1986, as amended, section 871(m). Thus, a constructive dividend that results from a non-arm's-length transaction between a corporation and a related party is a dividend. In the case of the United States, the term "**dividends"** includes amounts treated as a dividend under U.S. law upon the sale or redemption of shares or upon a transfer of shares in a reorganization. See, e.g., Rev. Rul. 92-85, 1992-2 C.B. 69 (sale of foreign subsidiary's stock to U.S. sister company is a deemed dividend to extent of the subsidiary's and sister's earnings and profits). Further, a distribution from a U.S. publicly traded limited partnership, which is taxed as a corporation under U.S. law, is a **dividend** for purposes of article 10. However, a distribution by a limited liability company is not taxable by the United States under article 10, provided the limited liability company is not characterized as an association taxable as a corporation under U.S. law. The term "**dividends**" does not include distributions that are treated as gain under the laws of the state of which the company making the distribution is resident. In such case, the provisions of article 13 (gains) shall apply (for example, the United States shall apply IRC section 897(h) and the regulations thereunder). Finally, a payment denominated as interest that is made by a thinly capitalized corporation may be treated as a **dividend** to the extent that the debt is recharacterized as equity under the laws of the source state (in this case, the United States). ***U.S. Treasury technical explanation to the 2013 protocol to the treaty.***

Dividends received by a Spanish company from U.S. real estate investment trusts and U.S. regulated investment companies are subject to special rules. ***See Article XIV(2) of the 2013 protocol to the treaty.***