

SPANISH TRANSFER PRICING AND THE IMPORTANCE OF FAIR MARKET VALUATION - ERNST & YOUNG ABOGADOS

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La Ley 36/2006 de 29 de noviembre ha introducido medidas para combatir el fraude fiscal e incluye modificaciones importantes en el artículo 16 de la Ley del Impuesto sobre Sociedades. Segiºn los objetivos de la nueva ley, las enmiendas tienen el fin de adaptar la legislación española relacionada con los precios de transferencia a las directrices de la OCDE y a los códigos de conducta del Foro europeo de precios de transferencia de la Unión Europea. Los autores, José Luis Gonzalo, Ramón Palacín, Florencia Gaido, Juan José Terraza y Carlos Gabarró, todos ellos letrados del bufete internacional Ernst & Young Abogados, enumeran los principales objetivos del texto refundido de la ley y ofrecen una percepción del impacto de la legislación en términos prácticos.

Law 36/2006 enacted on November 29th 2006 ('the Law') has introduced measures to avoid tax

fraud including important amendments to Article 16 of the Corporate Income Tax Law ('CITL'), which governs the tax treatment of transactions among related parties.

According to the Law's declared objectives, the amendment aims to adapt the Spanish legislation on Transfer Pricing to the OECD Guidelines and that of the European Union Joint Transfer Pricing Forum.

In this sense, the proposed amendments aim to combine Spanish legislation and the practice of the Tax Authorities with that of other countries, thus providing greater certainty on the tax audit procedures.

The new legislation is applicable to tax periods beginning from December 1st, 2006, and establishes the obligation for Spanish taxpayers to determine and prove the arm's length remuneration of transactions with related parties.

Documentation requirements are expected to become applicable during the course of 2008. Failure to comply with them will result in the application of penalties. Notwithstanding this, multinational groups need to bear in mind that, although statutory documentation requirements are not yet in force in 2007 (except for certain transactions), the burden of proof is still currently on the taxpayer. Therefore, the tax administration could require taxpayers to support the transfer pricing policy applied by means of an appropriately documented transfer pricing analysis. Hence, for those groups that do not have appropriate documentation, it is advisable to begin preparing it as soon as possible.

Further regulations, approved during the course of 2007, address the specific documentation requirements and applicable exceptions, largely in line with the recommendations of the EU Joint Transfer Pricing Forum.

Main objectives

The main objectives and goals of the Law are to:

- (i) introduce the principle of the market price valuation;
- (ii) establish for the first time in the Spanish tax legislation the need to document the transfer pricing policy between related parties;
- (iii) adapt the Spanish legislation to the international context on valuation methods and their hierarchical application;
- (iv) introduce for the first time in Spain a specific penalty regime for infringements on transfer pricing issues;
- (v) establish the possibility to make secondary adjustments; and
- (vi) encourage taxpayers to collaborate with the Tax Authorities by making the regime of advance pricing agreements flexible and introducing a specific legal regulation on mutual agreement procedures.

Practical impact

The new legislation incorporates a concrete mandate that all transactions between related parties must be valued at fair market value regardless of the fact that the actual valuation agreed may or may not produce a deferral or lower taxation in Spain.

The new arm's length fair market value criteria implies, among other things, that Spanish taxpayers must know, apply and document the fair market value of their inter-company transactions.

There is no doubt that this transfer pricing regulations reform and, particularly, the introduction of

statutory documentation requirements, imply a fundamental change for Spanish taxpayers since, from now on, they will be obliged to apply the fair market value principle and to document all their related party transactions adequately. This will mean a heavier administrative burden for taxpayers, but at the same time, an increase in the legal certainty.

Additionally, aspects such as the modification of the hierarchy of valuation methods, the introduction of the Transactional Net Margin Method (TNMM), as a valid method to determine the fair market value and the new regulation on expenses derived from the provision of services and cost contribution agreements between related parties, place the Spanish transfer pricing rules in line with those of other countries.

Lastly, the fact that the Law introduces specific penalties for cases of infringement, not only regarding the obligation to assess related party transactions at fair market value but also with regard to the obligation to maintain statutory documentation, makes clear the importance that the Spanish Tax Authorities grant to transfer pricing issues (especially, in an international context) and, as a consequence, the diligence that the taxpayer will have to use in the fulfilment of these new tax obligations.

This is an extract from Ernst & Young Abogados Report: Important amendments to Spanish Tax Legislation on Transfer Pricing written by José Luis Gonzalo (JoseLuis.Gonzalo@es.ey.com), Ramón Palacín (Ramon.PalacinSotillos@es.ey.com) and Florencia Gaido (Florencia.GaidoCerezo@es.ey.com) in Madrid; Juan José Terraza (JuanJose.Terraza Torra@es.ey.com) in Barcelona; and Carlos Gabarró (Carlos.Gabarro@ey.com) in New York.