



UPDATES OF THE CURRENT REGULATION FOR RELATED PARTY TRANSACTIONS IN CORPORATE TAX¹

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I. Taxation of transactions between related entities has been amended upon the approval of Law 27/2014, of 27 November and Royal Decree 634/2015, of July 10, which approved the Guidelines for Corporate Tax.

The legislation seeks to regulate transactions between non-independent entities that, taking advantage of the fragmentation of the tax system, seek to defer benefits to countries where taxation is less or, at the Spanish domestic level, intends to favor lower taxation for entities, from that, which corresponded, if these transactions were made among independent operators, proceeding to make the corresponding bilateral adjustments. Usually, at the national level this assessment different from that given by market value, responds to an intention; of transfer losses to entities whose taxable bases are positive, transfer benefits to entities where deductions yet are pending application or negative taxable incomes pending offset yet are about to prescribe, to modify the net turnover so as to become eligible for tax benefits, ...

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However, internationally, transactions between related entities in the territory of the European Union, are treated according to the provisions in the context of the Forum on Transfer Pricing, therefore the possible bilateral adjustment can only be made if the operations performed are subject to Spanish territory since otherwise, the Spanish Administration has no authority to make such an adjustment.

Regarding operations outside the European environment, these are treated in accordance with the provisions of the OECD and the double taxation Agreements signed with third party countries.

When two or more related entities perform operations that do not adjust to the valuation that would be made between independent parties, it is a behavior that usually responds to an intention to avoid tax (undeclared benefit sharing, application of more favorable tax rates, covert capital injection, artificial generation of fiscal expenditures, ...) though, sometimes these valuations respond to economic constraints (exchange rate fluctuations or risks arising from conjectural situations).

Among the main changes introduced by Law 16/2007 of July 4, concerning the reform and adaptation of the Spanish commercial Law on accounting matters for its international harmonization based on the regulations of the European Union, include the following:

- The market value is reintroduced as an interpretative rule, without prejudice to the subsequent valuation introduced by Law 27/2014, which identifies fair value with market value without exemption of any of the known valuation methods.
- The valuation modification is no jurisdiction of the Tax Authorities.
- New family relationships are introduced, thus the linkage perimeter expands.
- The scrutiny procedure of the market value is modified.
- A reference for entities under income allocation was introduced, as the rule refers to the "participants". This regime includes both entities and commercial companies.
- A new documentation requirement was introduced through the "Master File" and "Country File" or "Local File"³ .

³ This article is not about international taxation, for an earlier analysis to the applicable regulation as of January 1, 2015, see: GARCÍA PRATS, F. A. (2009): "The agreement models, its guiding principles and its influence on the double taxation Conventions" *Cronica Tributaria*, no. 133, pp. 101-123.



- The new sanctioning regime includes the obligation to document related party transactions.

- A Special treatment for cases of compensation of professional partners was established, this regime was modified again on the current regulatory Law for Corporate tax.

The main innovations introduced in the recent legislation are discussed throughout the following pages.

II. In regulating related-party transactions it is important to make a distinction between the applicable regulation up to December 31, 2014 and that one effective as of January 1, 2015. Regarding all transactions carried out up to December 31, 2014, for their valuation and corresponding correction, according to the provided in the following regulations:

- Article 16 of Royal Decree Law 4/2004, of March 3 (BOE (Official Bulletin, for its initials in Spanish) March 11, 2004).

- Articles 16-29 of Royal Decree 1777/2004 of July 30 (BOE, 6 August 2004), whereby the Corporate Tax Regulation is approved, partially amended by Royal Decree 1793/2008, November 3 April (BOE, November 18, 2008).

Transactions carried out as of January 1, 2015; transactions between related parties are regulated by:

- Article 18 of Law 27/2014, of November 27 (BOE, November 28, 2014) whereby the regulating Corporate Tax Law approved.

- Royal Decree 634/2015, of July 10 (BOE, 11 July 2015) whereby the Corporate Tax Regulations are approved.

On the other hand, the common rules for any related party transactions, regardless of the moment when they have been carried out are contained in the following standards:

- Law 36/2006 of November 29 (BOE, November 30, 2006), Actions for the prevention of tax fraud.



- The accounting and commercial regulations established in Law 16/2007 of July 4, to reform and adapt the Spanish Commercial Law on Accounting Matters for its international harmonization based on the regulations of the European Union and Royal Decree 1514/2007 of November 16, which approves the General Accounting Plan, partially amended by Royal Decree 1159/2010 fixing the NOFCAC (Standards for the Preparation of Consolidated Financial Statements, for its initials in Spanish.

- Works of the EU in the context of the European Forum on Transfer Pricing, inspired by the guidelines and reports of the OECD on transfer pricing.

- Judgments of the Court of Justice of the EU on linked financial transactions, to practices of groups aimed at offshoring income, seeking its location in countries with lower taxation.

- Law 16/2007 of July 4, reforming and adapting Spanish commercial law on accounting matters for its international harmonization based on the regulations of the European Union.

- Royal Decree Law 1/2010, of July 2, approving the Consolidated Capital Companies Act is approved.

III. Article 18.1 of the Law 27/2014 of November 27, states that linked operations are those carried out between related persons or entities (according to the definition of the scope of linkage, which is defined below) and will be assessed according to their market value. It being understood, as that which would have been agreed by independent persons or entities under conditions which respect the principle of free competition.

1. The perimeter of linkage is configured as a basic subjective element for the determination of the applicable rules, for which, Article 18.2 sets the following criteria for consideration of related entities⁴:

⁴ The current legislation does not take into consideration the group of cooperatives within the perimeter of linkage.



- a. Internal relationship between society and the personal elements of its organizational structure: partners, counselors, administrators and relatives.
- b. External relationship between society and the personal elements of another entity.
- c. Group of companies Article 42 of the Commercial Code⁵.
- d. Indirect participation requires a share of at least 25% of the taxable capital.
- e. The relationship between the company and its permanent establishments; fiscally this linkage is limited to transactions between resident companies and permanent establishments abroad.

The most frequent linked operations, which often occur in the context of family businesses, are related to the following:

- a). Personal Incomes, corporate incomes done by a partner.
- b). Participative loans made by partners.

⁵ The wording of Article 42 of the Commercial Code consonant to the amendment introduced by Law 16/2007, of July 4 "Any Parent Company of a group of companies will be required to prepare the annual accounts and consolidated management report as provided in this section. There is a group, where a company holds or may directly or indirectly hold control of another or others. Control is presumed to exist, specifically, when a company, which qualify as dominant, is in relation with another company, which qualifies as a dependent, in one of the following situations:
a-holds the majority of voting rights.

b- It has the power to appoint or remove a majority of the members of the board.

c- it can avail under agreements with third parties, most of the voting rights.

d- it has appointed with its votes the majority of the board members, who hold office at the time of formulating consolidated accounts and for the two fiscal. In particular, shall be presumed circumstance when most members of the board of the acquired company are members of the board or senior executives of the parent company or another dominated by it. For the purposes of this section, to the voting rights of the parent company will be added those hold through other subsidiaries, or by other persons acting on their own name, but on behalf of the parent company, or other dependent companies or those available in agreement with any other person. "



- c). Lease or transfer of business premises owned by the partner.
- d). Transactions between companies belonging to the same trade group.

Scheme of the linkage perimeter

Previous elements to consider:

- Entity
- Partners
- Administrators
- Relatives (through third grade)

Group Definition:

- Art. 42 Commercial Code
- To control
- Vertical Participation

Relationship entity-partner

- Participation \geq 5% (1% listed)

Relationship entity- management

Relationship entity- spouse and relatives of partners and / or directors of the entity or another group

Relationship of two entities of the same group

Relationship of an entity and the partners of entity partners if they belong to the group

Relationship of an entity and the directors of another group entity

Relationship of one entity and another indirectly owned by 25% or more.

Relationship between two entities in which the partners directly or indirectly have a participation of 25% or more.

Relationship of a resident entity in Spain and its permanent establishments abroad or in Spain.



2. According to the provisions of NECA (Elaboration Standards for Annual Accounts, for its initials in Spanish) 15 defined as related party transactions⁶ those carried out between two or more entities in which one exercises or has the ability to exercise directly or indirect control over the other, or, if it exerts significant influence in making financial decisions and in exploiting the other, as in the case of group, multigroup or associate companies.

Specifically, from an accounting⁷ perspective, are considered to be related parties:

a- Companies considered like companies of the group⁸, associated companies⁹, multigroup¹⁰ or jointly controlled entities, as defined in NECA PGC 13¹¹, unless it is controlled by a Public Administration.

⁶ Note 23 of the Report contents defines and specifies the minimum information to be supply regarding transactions with related parties. Meanwhile the NRV (Valuation and Registration Guidelines, for its initials in Spanish) 21 determines how to record and evaluate transactions between group companies. In addition, the Law 36/2006 of November 29, on Measures for the Prevention of Tax Fraud amends Article 16 of the CIT (Corporate Income Tax, for its initials in Spanish) Law, ordering the essential principles for the required documentation.

⁷ RD 1514/2007 which approves the General Accounting Plan that came into force on 1 January 2008, and partially modified by RD 1159 / 2010 by which NOFCAC were approved.

⁸ Group Companies include those entities that qualify to form a trade group, according to the provisions of Article 42 of the Commercial Code, i.e., if the General Board of Shareholders controls the votes. The NECA 13 defines the concept of Group Company, associated company and jointly controlled / multigroup company.

⁹ Associated companies are those which, although are not part of the group, exert a significant influence over the entity because they have an important role to contribute in their activity, creating a lasting linkage relationship.

Article 47.3 of the Commercial Code defines as significant influence the following:

- must exist participation in it.
- It must create a lasting relationship, not speculative.
- Have the power to intervene in decisions related to financial and operating policies without having the control.
- This should be destined to contribute to the activity of society.

Significant influence is presumed, unless otherwise proved, when one or more group companies hold at least 20% of the voting rights of a company that does not belong to the group.

It can demonstrate the existence of significant influence through:

- Representation that is given to the Board of Directors or to the equivalent governing body of the investee.
- Participation in the policy-setting processes.
- Relevant transactions with the investee.
- Exchange of management personnel.
- Provision of essential technical information.



b- Individuals who directly or indirectly have any share in the voting rights of the company or the parent company of the same, thus allowing them to carry on one or another significant influence. They are also included close relatives of individuals.

c- The key personnel of the company, defined as those individuals with authority and responsibility for planning, directing and controlling the activities of the company, either directly or indirectly, or of its dominant, including administrators and managers.

d- Regardless of the above two points, companies on which anyone can exercise significant influence.

e- Companies that share any director or officer with the company, unless he/she does not exert a significant influence on the financial and operating policies of both companies.

f- People who have close relatives consideration ¹² of the representative of the administrator of the company, when this is also has a legal authority.

¹⁰ Those companies that are not included as subsidiaries but that are managed by one or more companies of the group, participating in their capital stock together with one or several other persons outside of it, exercising joint control.

Multigroup companies: Specifically, when two entities are jointly managed by: one or several companies of the group; or by one or more entities or persons outside the group. In jointly controlled companies exist an agreement in decision-making, even while not having effective control.

According to the stated in Valuation Standard 20th of the General Accounting Plan: "It is a statutory or contractual arrangement whereby two or more people who will be called " participants " agree to share the power to govern financial policies and operating on an economic activity in order to obtain economic benefits, so that strategic financial and operating activity concerning decisions require the unanimous consent of all participants' policies.

¹¹ For the purposes of presentation of annual accounts, it is understood by group:

- a- Vertical Group: When two entities are linked by a provision similar to Article 42 of the CC.
- b- Horizontal Group: When entities are controlled by any means, or by one or more natural or legal persons acting jointly or being under a single management through agreements or statutory clauses.

¹² Se entiende por familiares próximos aquellos que podrían ejercer influencia, entre los que se encuentran:

- a- El cónyuge o persona con relación análoga de afectividad.
- b- Los ascendientes, descendientes y hermanos cónyuges o personas con análoga relación de afectividad.
- c- Los ascendientes, descendientes y hermanos del cónyuge o personas con análoga relación de afectividad.
- d- Las personas a su cargo o a cargo del cónyuge o persona con análoga relación de afectividad.



g- Pension plans for employees of the company or any other which is linked party of this.

3. The scope of fiscal linkage was regulated in article 16.3 of LRD (Legislative Royal Decree) 4/2014¹³ and now article 18.2 of Law 27/2014 that establishes as linkage perimeter:

a- According to the internal relationship that is maintained: Thus, linked operations are those carried out by an entity or its partners or participants; equally linked are those operations performed by an entity and its advisors or managers and relatives; spouses or persons united by family relationships, in direct or collateral line, by consanguinity or affinity, as far as the third degree of the partners or participants, advisors or managers, except with respect to the remuneration for the performance of their duties.

b- Taking into consideration the external relationship, one is before related party transactions when they are carried out by two entities belonging to the same commercial group or entity and the advisors or managers of another entity belonging to the same group.

c- A corporation and the spouses, or people united by family-relationships, in direct or collateral line, by consanguinity or affinity, as far as the third degree when both entities belong to the same group.

d- In the cases of indirect participation. Related operations are performed by an entity and another entity indirectly owned by the first one in at least 25% of the taxable equity calculated as provided in article 69 of the CTLRT (Corporate Tax Law Refunded Text) and article 60 of the CTL (Corporate Tax Law¹⁴). Two entities in which the same partners, participants or their spouses or

¹³ They are no longer in the scope of linkage according to the developed by Law 27/2014, with respect to the provisions of the foregoing law:

1. An entity or the partners or participants of another entity, either natural or legal person, when both belong to the same group.
2. An entity nonresident in Spain and its permanent establishments in Spain.
3. Two entities that are part of a group that pay taxes in the regime of cooperative corporations.

¹⁴ The new legislation suppresses the reference to cooperative corporations.



people united by family relationships, in direct or indirect line, in at least 25% of the social capital or own funds.

e- An entity resident in Spain and its permanent establishments abroad.

Some practical examples of linkage:

There is no linkage between the parties involved:

a. If the economic relationship is given exclusively between natural persons.

b. If the relationships between two entities are given exclusively for the fact of being partners of the same entity.

Example 1¹⁵.

There is no linkage between A and B even though there is a linkage between A and C and between B and C.

A -----40% -----C

B -----35% -----C

There is linkage between the three entities:

A -----40% -----B ----- 80% -----C

Examples.

Example 2.

The AAA Corporation participates in 85% of the social capital of BBB Corporation. At the same time BBB participates in 90% of the social capital of CCC. Do they form a group, according to the provisions in article 42 of the Commercial Code?

Answer: The three corporations form a group, according to the provisions of the Commercial Code and therefore, they are linked.

Example 3

The AAA Corporation participates in 90% of the social capital of BBB Corporation, which in turn participates in 30% of CCC Corporation. Do the three corporations form a group?

¹⁵ Some examples have been taken from the Conferences organized by REA-REGA Auditors on July 2, 2015, by Mrs. Marisa Rey speaker.



Answer: Corporations AAA-BBB-CCC does not form a group because BBB do not control CCC. Nevertheless, they are linked because AAA participates indirectly in CCC in more than a 25% ($90\% \times 30\% = 27\%$).

When the valuation of the transactions do not respond to the market reality, that one usually responds to a defrauding purpose, as following specified:

- 1- An unreported distribution of profits.
- 2- To transfer losses to corporations with positive taxable bases or with deductions pending of application and which are close to losing that right.
- 3- Modify the net turnover to qualify for tax benefits.
- 4- Covert capital contributions.
- 5- A generation of artificial tax expenditures.
- 6- Application of types of burden that favors the company.

However, this valuation may not be identified with the market value in those circumstances in which they pretend to avoid fluctuations in the exchange rate, national type restrictions or risks inherent to current situations, so that they do not always correspond with attempts of tax avoidance.

IV. There is a discrepancy between fiscal and accounting valuation because, while accounting imputation is to be done at fair value, the fiscal imputation must be done at market value.

1. The accounting scope does not specifies the percentage of participation in the linkage between the partner (manager), although, requires that the participation in the voting rights shall be enough in order to exercise significant influence on the entity.

The linkage perimeter for accounting purposes only takes into account relatives as far as the second degree in direct or collateral line, consanguinity or for affinity. However, it includes people that, without being legal relatives stand in a similar situation. Regarding to the linkage of the advisors they are taken in account, as well as the key personnel of the company or its dominant company, and includes the executive staff and its close relatives.



2. In the fiscal scope the participation percentage varies according to the applicable rule. According to the applicable regulation up to December 31, 2014 it was necessary a 5% of participation if the entity is not listed in the regulated market, decreasing this percentage to 1% for entities listed in a regulated market. The participation percentage changed to 25% as of January 1, 2015.

The linking perimeter for fiscal effects includes relatives as far as third degree included. It also limits the linkage to advisors and their relatives.

Example 4

Determine if related party transactions exist at a fiscal level in the following operations:

Corporation AAA that is not listed in the Stock exchange is part of a group that has performed the following operations throughout the fiscal year:

- a- Has received a loan from the dominant corporation from its commercial group.
- b- Has given a loan to an associate corporation.
- c- It provided services to a brother of the controlling shareholder.
- d- If it received a delivery of goods from a shareholder holding 1% of the shares.
- e- Ditto the above with a corporation manager.
- f- Ditto the above with a high executive of the entity.
- g- Ditto both above, with an employee of the corporation.

Answer:

a. This is a related party transaction, because the operations performed between a corporation and its dominant, are linked operations.

b. In the associated companies the same previous criteria is followed.

c. Related party transactions are those performed with shareholders or their relatives as far as the third degree included, by direct or collateral line. The brother is a relative of second degree.

d. There are not related party transactions the ones performed with a shareholder holding 1% of the shares.



- e. It is a related party transaction.
- f. It is not a related party transaction.
- g. It is not a related party transaction.

Certainly, according to what is provided in article 18 of CTL, the following amendments are introduced¹⁶:

a. The assumptions of an entity and the partners or participants of another entity are subject to elimination, when both parties belong to a group, of an entity nonresident in the Spanish territory and its permanent establishments in the mentioned territory; and of two entities that are part of a group that pay taxes in the regime of groups of cooperative entities.

b. The participation percentage is increased from a 5% to 25% in the linking cases for the relationship partner-entity, eliminating the linkage at 1% for the case of registered corporations.

c. The remuneration of managers and advisors for the exercise of their functions is exempted from the assumption of linkage between a company and its managers and advisors.

V. With regards to the methods to determine the market value the preference previously existing is eliminated, and other techniques and valuation methods are accepted alternatively, provided that the principle of free competition is respected.

Law 36/2006 establishes in paragraph III of the Proclamation of Motives that “the acquisition price for which these operations should be recorded should correspond to the amount that would be agreed by independent persons or entities in conditions of free competence, understanding for it the market value, if there is a representative market or, or otherwise, that derived from applying specific models and techniques of general acceptance and in harmony with the principle of prudence”.

¹⁶ Lefebvre (2015) *Memento Express Tax Novelties 2015*. Francis Lefebvre Editions, pp.17.



Specific valuation rules are also established for operations of shareholders with corporations of professionals at law level. These rules were already statutorily regulated in similar terms to the current ones¹⁷.

The tax regulations applicable until December 31, 2014 affect related party transactions performed as of February 19, 2009. At a commercial and accounting level, it affects the related party transactions performed as of January 1, 2008. An action to avoid fraud would be attempting to stop, the modification of taxable bases, through related party transactions, with the purpose of evade or pay taxes.

Concerning transactions between related companies, since there are no conflicting interests; when the transactions are linked to the normal business of the entities that participate on these (purchase-sales of goods, provision of services, ...), it is expected, that the fixation of the prices be determined by the general policies of the selling entity if there is no adequate documentation for the determination of the transference prices , so that the fair value can be assessed according to fiscal criteria.

Physically, it is necessary to differentiate the valuation given to related party transactions in the indirect and in the direct taxation.

In the case of the **Value Added Tax**,

The market valuation rule will be applied in the following cases.

- If the addressee of the good or service does not have right to total deduction of the supported VAT and the consideration agreed is lower than the one that would correspond in free competence conditions.

- When the businessman or the professional who delivers the good or renders the service determines the deductions applying the pro rata rule and refers to:

o An operation that do not generate the right to a deduction, if the fixed consideration is lower than the market value.

o An operation that generates the right to the deduction, if the fixed consideration is higher to the market value.

One considers that there is a link in the Value Added Tax :

- Transactions between taxpayers and people linked to them through commercial or labor relationships.

¹⁷ Lefebvre (2015): Memento Express. “*Novedades Tributarias 2015*”. Francis Lefebvre Editions, pp. 17.



- Transactions between taxpayers and their spouses or consanguinity relatives as far as the third degree.

- Transactions between non-profit entities and their founders, associates, employers, statutory representatives, members of the government bodies, spouses or relatives as far as the third degree inclusive of any of them.

Regulatory Law 27/2014 for Corporate Tax requires a correct valuation of these operations in the Corporate Tax applying the provisions of article 18 of LIS (for its initials in Spanish). Entities are required to document the related party transactions that they perform and they must keep all the support documentation of the price fixed by these operations, since; it may be required at some point of the verification and investigation¹⁸ process.

Specifically, article 18.4 of Law 27/2014, of November 27 establishes the following methods for the determination of the market value:

- a) Comparable uncontrolled price method
- b) Increased cost method
- c) Resale price method
- d) Method of profit distribution
- e) Operational net margin method

Which contents will be developed further on.

Special case: professional partners

The relationships between partner and corporation are subject to the principle of legality. For the purposes provided in article 18.6 of the Regulatory Law on Corporate Taxes, the tax payer may consider that the agreed value matches the normal market value in the case of provision of services by a professional partner, physical person, to a related entity as long as the requirements that follow are met in relation to the corporation and the amount of the remunerations:

With regards to the corporation, the entity must be a company smaller than those provided in article 108 of the Tax Law, in which more than 75% of their revenues of the fiscal year come from the development of professional activities. On

¹⁸ A review of the new regulations may be consulted at: Lagos Rodríguez, G (2015): “The taxability of the related party transactions in the new Corporate Tax”. *Quince Fiscal*, n° 18, pp.19-32.



the other hand, the entity must have adequate material and human resources and the positive results of the fiscal year, before the deduction of the remuneration corresponding to all professional partners for providing their services.

Regarding to the amount of the remunerations, the CTL establishes that the remunerations corresponding to all of the professional partners for providing their services to the entity must not be less than 75% of the previous outcome. On the other hand, the amount of the remunerations to each of the professional partners must meet the following requirements:

a- To be determined in function of the contributions made by them to the proper functioning of the corporation, it is necessary that the qualitative and/or quantitative criteria that are applicable are stated in writing.

b- Not to be inferior to 1,5 times the average salary of the employees of the corporation who perform similar functions to those of the professional partners of the entity.

c- In their absence, the amount of the said contributions may not be less than 5 times the Income Public Indicator to Multiple Effects.

Breach of the provided requirement in paragraph b) in relation to any of the professional partners will not preclude the application of the provisions of this paragraph to the remaining professional partners.

In this sense CEAC (Central Economic-Administrative Court) (11-9-14) states that the invoicing of the professional or artist to his corporation, when it counts with human and material resources for the development of the activity, cannot be assessed according to the value fixed by the parties, instead it should be valued at market price. This value must match, in this case, the invoicing prepared by the corporation to third parties, once the opportune corrections to obtain the equivalence are made - such as discounting the expenses necessary for the activity in which the corporation may have incurred.¹⁹

When transactions are not linked to the normal business of the entities involved, the fair value substantially weakens as value given to the transaction made between independent parties. In these cases, one has to analyze the value given to the transaction and identify it with a reliable value that could be agreed between

¹⁹ Lefebvre (2015): *Memento Express*. "Novedades Tributarias 2015. Francis Lefebvre Editions, pp.89.



independent parties. Being sometimes, necessary going to appraisals and assessments made by independent experts.

1. The valuation of related party transactions has its own definitions from a fiscal point of view and from an accounting perspective. Thereby the Commercial Code in article 34.2 establishes that “the accounting of operations will take into consideration not only their economic reality but also their legal form”. Meanwhile, ICAC (Institute of Accounting and Audit of Accounts, for its initials in Spanish) Consultation n° 64 of December provides that the treatment given to intragroup operations on individual accounts should take into account that “when there is no independence between the parties involved in a related party transaction, generally a hybrid result is obtained, one in which is possible to distinguish two different but related operations. A main one, constituted by the transfer of the property or a right and, other secondary, because when the transaction is valued at a different price other than the market one, a movement of assets between the independent parties originates, favoring one or the other, with the difference between the priced agreed and the market price.”

Market value

The identification between market value, fiscally considered, and the fair value, used from the accounting point of view, forces to make a brief reference on the concept of accounting “fair value”

The General Accounting Plan establishes that the transactions between related parties will be accounted for within the conceptual framework that defines the concept of fair value as “*the amount for which an asset could be exchanged or a liability settled, between concerned parties and duly informed, who carry out a transaction in conditions of mutual independence. The fair value will be determined without deducting the costs of the transaction which might arise from its alienation*”²⁰. Generally the fair value is calculated with reference to a reliable market value, in which case, the market value and the fair value will match.

²⁰ In accordance to the provisions of the Commercial Code the fair value is calculated with reference to a reliable and free market value, by applying valuation models and techniques with the requirements specified in the regulations. In accordance to the provisions in article 38.f of the Commercial Code:

- The assets will be accounted for the purchase price or for the production cost.
- The liabilities for the value of setoff received in exchange of incurring in a debt plus the accrued interest pending of payment.



The determination of the market value is not easy, a fact that has been recognized by the Supreme Court in Sentence of 10-1-2007 when emphasizing that “setting a market price is a very difficult task because sometimes, the transactions between related corporations are so singular that there is no clearly defined market of the them in the field of independent business”.

Royal Decree 1514/2007, approving de General Accounting Plan in its Valuation Rule 21 establishes that “in general, and without prejudice of the provisions of the paragraph below, the elements object of the transaction will be accounted at the begining for its fair value. In this case, if the price agreed in an operation differs from its fair value, the difference must be registered according to the economic reality of the operation.

The fair value will be calculated as of the trading price for the elements that are traded in a secondary market and, in other case, through the application of valuating

Provisions will be accounted for the current value of the best estimate of the amount necessary to face the obligation, on the closing date of the balance sheet.

In accordance to provisions in the General Accounting Plan, approved by the RD (Royal Decree) 1514/2007, on November 16, it is in paragraph 6 of the Conceptual Framework, dedicated to the exposition of the assessment criteria and the definitions related to them where it is defined that they must be assessed by the fair value:

- Certain operations of tangible fixed assets and intangible (and real estate investments):
 - o Nonmonetary contributions
 - o Swaps
- Most of the financial instruments. Rule 9.a of financial instruments together with the rule that regulates the so called “Business Combinations” are with no doubts the most relevant novelty in the new General Accounting Plan
- Grants, donations and legacies.
- The business combinations. Rule 19.a regulates the so called business combinations understood as those operations in which a company acquires control of one or several business, in this case the rules governing the accounting treatment of these operations are embodied in the so called “Acquisition Method” (paragraph 2 of the said rule), whereby, in general, the assets acquired and the liabilities assumed by the acquiring company are accounted for its fair value. It also highlight the fact that the commercial fund is not amortized and the eventual negative difference arising in the combination is recorded directly in the account of losses and profits at the date on which the control of the acquired business is taken.
- The transactions between companies of the group.

For a more detailed study of the concept of “fair value” refer to Molés Molés, C. (2009): “Financial assets and liabilities assessed at fair value. The Impact of the economic crisis.” State Tax Administration Agency. Dissertation presented at the IV Course of High Specialization in Financial Taxation celebrated at the School of Public Finances of the Institute of Fiscal Studies in the first semester of 2009. (January 2014). Available at: http://www.ief.es/documentos/recursos/publicaciones/revistas/cuadernos_formacion/09_2010/07.pdf.



models and techniques. The difference between the fair value and the one effectively agreed between the parties must be reflected in the financial statements, according to an economic point of view, having the corresponding tax repercussion.

The fair value will be determined by the traded price in an active market, understood as such, one on which the following conditions are given:

- The goods and services exchanged in the market are homogeneous.
- There are potential buyers and sellers at any moment for a particular good or service.
- Prices are known and easily accessible to the public.
- They reflect real, current and regular market transactions.

A corporation buys its own shares to another corporation in order to avoid tensions and disagreements produced between shareholder groups that hamper and hinder the management of the corporation. In return, the transferor entity receives a property owned by the entity acquirer of the shares. Even though the sales value of the shares has been agreed, between both corporations, an independent expert has valued the shares acquired at a lower price. The DGT (Tax General Directorate, by its initials in Spanish) (CV (Acronym of Binding Consultation) 17-7-13) deems that even though the operation is carried out between linked corporations, it is considered that the acquirer entity has an instrumental character in the operation, as a solution to a pact between shareholders, in order to reach an agreement to end disputes between the family group owner of 75% of the capital of the corporation and the corporation that owns 25% of it. It is therefore, an operation between independent parties, being subject to the general rules of the Corporate Tax, and to the margin of the documentation required, established for related party transactions, considering it valid, for tax purposes, the value agreed by the partners, independently that an independent expert determine a different value.²¹

The normal market value is determined by applying one of the five valuation methods established in article 18.4 of CTL that may be synthesized in the following:

Traditional Methods²² :

- Comparable uncontrolled price method.

²¹ Lefebvre, F. (2014): Memento Express. “*Novedades Tributarias*” 2014. Ediciones Francis Lefebvre, pp.99.

²² For a deep analysis traditional valuation methods refer to: TUERO FERNÁNDEZ, A. “*Analysis of the regime of the related party transactions in the Corporate Tax*”. Cuadernos de Formación. Collaboration 42/10. Volume 11/2010. Dissertation presented at the XII Course of High Specialization in International Taxation celebrated at the School of Public Finances of the Institute of Fiscal Studies.



- Increased cost method.
- Resale price method.

Subsidiary Methods:

- Method of distribution of result.
- Operational net margin method, denomination that replaces the net margin of the set of operations.

The innovation established by the Law 27/2014, with effects as of January 1, 2015 is the withdrawal of the priority established for the three valuation methods established by OCDE and only when, due to the complexity or the information relative to the operations, none of the first three methods could not be properly applied, then, the subsidiary methods could be applied to determine the market value of the operation.

The choice of the valuation method shall take into account the following factors: the nature of the related party transactions, the availability of reliable information and the degree of comparability between related party transactions and the ones that are not related.

In the situation of not been able to apply the abovementioned methods, other generally accepted valuation methods and techniques respectful of the principle of free competence may be used.

Royal Decree 634/2015 establishes in Section 1a of Chapter VI the specific valuation rules of the market value and in the Section 2a develops the mechanisms of verification of the related party transactions.

Comparable uncontrolled price method

This method compares the market price of a good or service in a related party transaction, with an equivalent, carried out in an unrelated transaction. Depending on the reliable information available, this method facilitates or not the valuation. It is the most complicated in practical application, as it requires a high degree of comparability between the operations, this is the most used method most used in the practice and the one which OCDE considers as the most direct application. On the other hand, it is the only one that values the operations in terms of the price. In the current legislation it has ceased to be the preferred method.



The National Audience (NA 13-3-14) gave reason to a petitioner, to which the Administration determined the market value of a property consistent with the valuation done by the Technical Department of the Delegation of the EAAT (State Tax Administration Agency, for its initials in Spanish). The entity understands that what is being sold are the rights on the property and since only one portion had been paid, specifically 22.9%, it is on that percentage that the market value has to be determined. The Court considers that the petitioner is right in the sense that the valuation of the Administration refers to the property, while in reality, what is being transferred is a portion of it, that corresponds to the portion paid, therefore the surplus should be calculated over the paid percentage²³.

Secret Comparable

In those cases where a trading price does not exist in an active market, the fair value will be determined as follows:

- Through the application of valuation models or techniques which determine the amount for which a transaction may be done between interested and dully informed parties, taking in account recent transactions in conditions of mutual independence between the parties.

- These techniques must limit the use of subjective considerations of non-accounting data.

- Effectiveness should be assessed periodically.

The use of the so called secret comparable to determine the ratios corresponding to net sales-consumptions generates powerlessness (TSJ Galicia 25-4-14), since the STAA, based on the confidentiality of the tax data, prevents from knowing the identity of the mercantile partnerships which invoicing volume is taken into consideration for establishing the resale price. Therefore, the use of secret comparable is proscribed in the framework of the procedure of the related party transactions, since such subjective methodology does not meet the requirement arising from the right of defense, consisting of an adequate motivation which allows the affected taxpayer to oppose to the valuation and regularization²⁴.

²³ Lefebvre (2015): *Memento Express. Tax Novelties 2015*. Editorial Francis Lefebvre, pp.78.

²⁴ Lefebvre (2015): *Memento Express. Tax Novelties 2015*. Editorial Francis Lefebvre, pp.79.



Resale price method

This method is applied to operations of resale of goods, provided that the reseller does not add substantially value to the product, but instead realize simple commercialization operations.

The price is calculated over the gross margin that the reseller would obtain with the resale of similar products, and subtracting from the sale value the gross margin obtained in independent conditions. The gross margin which the businessman had obtained from the resale of goods, deducting the cost of acquisition and the direct costs incurred in the distribution of the goods. Costs in which the provider of goods and services incurred are used, increasing the margin that usually is obtained in non-related transactions of similar characteristics. In addition to the provider's costs a margin is also applied, resulting in a benefit.

Increased cost method

This method is based on the gross margin and it is usually used in the valuation of productive activities of goods and services.

Consist in adding to the acquisition value the usual margin in independent operations. A comparison is done to the price of a product purchased to a related party company and resell to an independent company. To the extent that the added value is smaller, it is easier to apply.

Profit split method (Profit Split)

This method consists in assigning each party of the linked operation, the portion of the common profit derived from the operation, in such a way that these reflect the distribution among the independent parties. The profit is divided among the linked parties with regards to the operation and according to risks, assets and functions. It is used in those cases in which the transactions of the two companies are so interrelated that it is necessary to perform an individual analysis of the same. It will also be used when intangibles or highly valuable elements in the related party transactions exist, and which make difficult to obtain information about other type of non-related operations, of similar characteristics.



Operational gross margin method (previously gross margin of the set of operations)

In the practice it is one of most used valuation methods. It analyzes the net profits margin with an appropriate base, comparing it with the margin of benefits in non-related comparable operations or that which would be obtained by an independent company. Adjustments may be done in order to obtain the equivalence and to consider the particularities in the operation. It is often used in wholesale and retail distribution operations.

Valuation by AEAT

The tax payer may request to the Administration a valuation of the related party operations, this request must be accompanied of a proposal based on the market value according to the principle of free competition. This valuation has a validity of four years and there is a possibility of being modified, if the circumstances require such modification. It will be understood that the request has been rejected, by administrative silence, in the term of six months.

The Law 27/2014 establishes that it be could determined if the effects of its operations reach the operations of prior taxable periods, as long as the right of the Administration to determine the tax debt through an opportune settlement has not prescribed, nor a firm settlement that falls on the transactions object of the request exists.

Assuming that there is a significant variation of the economic circumstances existing at the moment of the approval of the agreement from the tax Administration, this may be modified to adequate it to the new economic circumstances.

The resolution that ends the process may:

- a) Approve the valuation proposal submitted by the tax payer.
- b) Approve, with the acceptance of the tax payer, a valuation proposal which differs from the one initially submitted.



c) Reject the proposal submitted by the tax payer.

The method to apply will have to take into account the following factors:

- The adequacy of the method according to the comparability analysis.
- The strengths and weaknesses of each method.
- The quality of the available information.

VI. The adjustments that could arise in the related party transactions may be of two types:

a) **Primary adjustment:** It forces the profit or the loss of the operation performed to pay the taxes in the corporation that has effectively generated them. It is a bilateral adjustment that modifies the taxable base upward or downward, as appropriate.

b) **Secondary adjustment** ²⁵: The appropriate qualification is given, according to the nature of the income. Taxes will be paid according to the qualification of the operation and according to the qualification of the difference between the agreed price and the market value that has not reach the transferor corporation. Three cases may occur:

i. That the difference between the agreed value and the market value is given in favor of the partner, in which case this amount will have the consideration of participation in profits for the participant partner, for the portion of the difference that corresponds to the percentage of the participation, having the right until 2014 to a deduction, due to internal double taxation. For the difference that does not correspond to the percentage of the participation, the participant partner will calculate it as return on movable capital in case of natural persons. For the investee entity both parties will be calculated as retribution of equity.

ii. In those cases in which the difference is favorable to the investee entity, this will be charged as contribution received from the partner to equity for the portion of the difference that corresponds to the participation percentage. For the portion of the difference that does not correspond to the participation percentage this will be an income to be incorporated in the taxable base of the tax. In

²⁵ For a deep analysis of the treatment of the secondary adjustment before the amendments introduced in 2014 refer to: Vadillo Casero, C.C. (2010): “the secondary adjustment in the new regime of related party transactions”. Cuadernos de Formación. Collaboration 23/10. Volume 10/2010. Pp. 251-281. Dissertation presented at the X Course of High Specialization in International Taxation celebrated at the School of Public Finances of the Institute of Fiscal Studies.



the case of a non-resident entity, the consideration is capital gain. For the equity partner it will have the consideration of increase of acquisition value of the participation, for the difference that corresponds to the participation percentage and the liberality for the portion of the difference that does not correspond to the participation percentage.

The Law 27/2014 states that the provisions of the secondary adjustment will not be applied when proceeding to asset restitution between related persons or entities in the terms established statutorily.

Once the market value and the fair value have been determined the following circumstances may be given:

a) That the agreed price coincides with the fair value and it is accounted for that value. In this case there is no hybrid operation, nor is necessary to give another qualification since the fair value and the market value coincide.

b) The price agreed does not match with the fair value but is accounted for this value. In this case there is a hybrid operation and therefore the qualification with accounting record for the difference between the market value and the market value is necessary.

c) The price agreed match with the market value and it is accounted for the price agreed. There is no hybrid operation and the qualification with accounting record is not done. From an accounting perspective, one considers that the price agreed is the fair value and it is recorded that way.

The extra-accountable adjustments are reserved to the assumptions in which the fair value and the fiscal market value used for the determination of the taxable base do not coincide. All this, without prejudice of the possible appraisal on behalf of the Administration.

The valuation rules and the verification procedure of the related party operations is described in articles 17-36 of the Royal Decree 634/2015, as of July 10, by which the Regulations of the Corporate Tax are approved.

VII. The documentation will only be provided to the State Tax Administration Agency in the event that the passive subject is required to do so. This documentation has to be available to the AEAT as of the deadline of the voluntary term of auto liquidation corresponding to the fiscal year in which the operations have been done.



This obligation has a finalist character and must allow the Administration to prove that the valuation done is adjusted to what is established in the effective rule, according to the provided in article 18 of the Law 27/2014. But the need for this documentation does not exhaust the possibility that the Administration may request additional documentation or information, if it is considered appropriate. However, the operations that should not be documented, do not have to be declared in the Corporate Tax.

As of January 1, 2015 the article 18.3 of the Law 27/2014 states that the related persons or entities, whose net amount of turnover, defined in the terms established in article 101 of the Law, is inferior to 45 million Euros, will submit a documentation with a simplified content, that will be applied to the following operations:

1. The ones made by IRPF(Income Tax of Natural Persons) taxpayers who declare their economic activity in objective assessment with entities in which those or their spouses, ancestors or descendants, individually or jointly among all of them, have a percentage equal or higher to 25% of the social capital or of the equity.
2. The operations for business transfers.
3. The operations for transfer of values or representative shares of the participation in equity of any kind of entity not admitted in negotiations in any of the regulated value markets, or that are admitted in negotiations in regulated markets located in countries or territories qualified as tax heaven.
4. Property operations.
5. Operations on intangible assets.

As of January 1, 2015 the conditions to benefit from the exemption of documentation have been modified, being exonerated from preparing such documentation the following cases:

- a. When the volume of transactions made with related entities for said period does not exceed as a whole 259.000€²⁶, independently from the size of the company and the internal or international character of the operations carried out.

²⁶ In this amount are not included those operations for which the documentation is demanded in all cases.



b. Linked operations carried out by an entity and its members or with other entities within the same group of fiscal consolidation, constituted by Economic Interest Groups and TBA's (Temporary Business Associations).

c. Operations done between entities integrated in one same group of fiscal consolidation and that had opted for this special regime.

d. Operations performed in the ambit of public offers for sale or acquisition of values.

On the other hand, the possibility to submit simplified documentation for those persons or entities whose net amount of the turnover²⁷ does not exceed 45 million Euros is established.

In all cases the entities that perform the following transactions are required to submit documentation:

1. Operations for the transfer of values or shares representative of the equity participation of any kind of entities not admitted to negotiate in any of the regulated value markets, or that are allowed to negotiate in regulated markets located in countries or territories qualified as tax heavens.

2. Operations done with natural persons who pay taxes in objective assessment regime for the operations done within their economic activity.

3. Operations for the transfer of business, portfolios, properties or operations with intangible assets that have that qualification according to accounting criteria.

The Corporate Tax Regulation, approved by Royal Decree 634/2015, of July 10, regulates in articles 13, 15 and 16 the requirements for documentation and information which related entities have to accomplish. Article 13, specifically, discusses the information and documentation that has to be included regarding entities and related party transactions. Article 15 refers to the specific documentation of the group to which the tax payer belongs and the documentation regarding to: structure and organization of the group, activities, that which refers to intangible

²⁷ Defined according to article 101 of the Law



assets, financial activity; and the fiscal and financial situation of the group. Finally, article 16 refers to the specific documentation of the tax payer.

VIII. The Constitutional Court (11-7-13. Rec 3705/11) formally validates the sanction regime for related party transactions introduced by Law 36/2006 and developed by the Regulation approved through RD 1793/2008. Despite the fact Judgment (by Judicial Decree 8-2-2011) defines that the regulatory development of the sanctions regime must ensure that the infractions which determines are in effect serious and consequent, with the severity of the fines legally typified, corresponding to the ordinary jurisdiction verify if proportionality between infractions and sanctions, exists. Likewise, it will correspond to such jurisdiction the control of the fidelity to the regulation of the developed law, as well as the respect to the principle of the lawful sanctioning²⁸.

Regarding to the tax infractions committed as of January 1, 2015, article 18.13²⁹ of LIS establishes as assumptions of serious infractions the following, regardless of whether the tax Administration make corrections or not:

- a) Not contributing or making it in an incomplete or inexact form or with false data or falsifying the required documentation, as legally provided,
- b) To state in the required documentation a market value that does not correspond to reality.

Regarding to the sanctions, in the case that the Tax Administration does not make corrections, the sanction will consist in:

- a) Fixed monetary fine of 1.000 Euros for each data and 10.000 Euros for the set of data, omitted or false, referred to each of the obligations of documentation that will be established statutorily.
- b) The sanction provided in the previous paragraph, will have as maximum limit the lower of the two following amounts:

²⁸ Lefebvre, F. (2014): *Memento Express*. "Novedades tributarias 2014". Editions, Francis Lefebvre, pp.88.

²⁹ Art. 18.13 1° *It constitutes tax infraction the lack of contribution or the contribution in an incomplete form, or with false data, of the documentation that, according to the provision in paragraph 3 of this article and in its implemented regulations, must keep available to the tax Administration the persons or related entities, when the tax Administration do not make corrections in the application of the provisions of this article.*



i. The 10% of the joint amount of the operations subjected to Corporate Tax, ITNP or NRIT (Non Resident Income Tax) performed in the tax period.

ii. The 1% of the net amount of the turnover.

In those cases in which corrections have to be done by the Administration, the infractions will be sanctioned with a proportional monetary fine of 15% on the amount of the sums that result of the corrections that correspond to each operation.

This sanction is incompatible with that, which, proceeds from the application of articles 191, 192, 193 o 195 of the General Tax Law.

However, the sanctions provided should be compatible with the ones established for resistance, excuse, obstruction or refusal to the acting of the Tax Administrator, provided in article 203 of the GTL (General Tax Law), for the carelessness on the prepared requirements. In any case, the provisions in paragraphs 1.b) and 3 of article 188 of the GTL, will be applied, regarding the reduction of 30% if conformity with the liquidation is signed, and a reduction of 25% for prompt payment.

IX. The last amendments introduced to the legislation applicable to operations done between non independent parties are aimed at limiting the possible tax advantage that these take from the tax system in order to defer the benefits among entities or the attempt to favor a lower taxation than the applicable among independent parties.

Current legislation differs according on the time of accrual of the operations, being December 31, 2014 the determining date for the application of one legislation, or the other.

Among the amendments introduced by the Law 27/2014 is the definition of the scope of the tax linkage, that leaves out of the scope of linkage some of the operations performed by the entity and its members or participants and those performed with their permanent establishments, when the entity is nonresident in the Spanish territory, as well as the corporations that are a part of a group of cooperative corporations. On the other hand, it is emphasized, that the participation of a member shall be 25% in order to be considered a related party transaction.



Concerning the controversial accounting and tax valuation of the operations performed between related parties, the priority of some valuation methods over others disappear, being able to apply both traditional methods (comparable uncontrolled price, resale price and increased cost) or the subsidiary methods (distribution of income and net margin method from the set of operations) indistinctly.

Concerning to the applicable valuation adjustments, one primary adjustment can be performed, one that modifies the taxable base upward and downward, as appropriate. Or, a secondary adjustment that analyzes the natures of the income and try to give them the qualification that corresponds.

One of the most important amendments is the one that refers to the obligation of documenting the related party transactions and the entities that are exempt of such obligation.

Finally, the infractions and sanctions established for the operations performed as of January 1, 2015, are very similar to the ones contained in the previous legislation and materialize when not providing or not completing the data that must contain the required documentation or register the documentation not corresponding to reality.



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