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Further Discrimination of Permanent Establishments: Tax Incentive to Maintain or Create Employment in Spain

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The Spanish 2010 General State Budgets Act contained an important innovation consisting of the incorporation in the Spanish tax system of a new tax incentive to maintain or create employment. The fact that this tax incentive is not applicable to permanent establishments (PE) raises the question of whether it constitutes an infringement of the non-discrimination principle that limits the freedom of establishment. In general, the principle of non-discrimination has had a significant impact on the Spanish tax system, mainly in relation to direct taxes and, in particular, on PE. The case we shall now analyse is an example of this type of discrimination, which is prohibited both under the non-discrimination of PE clause envisaged in double taxation treaties and pursuant to the Community freedom of establishment.

1. Introduction

The Spanish 2010 General State Budgets Act (Act 26/2009 of 23 December) contained an important innovation consisting of the incorporation in the Spanish tax system of a new tax incentive to maintain or create employment. This measure mainly affects legal persons although a similar incentive has also been envisaged for natural persons.

The Spanish Corporate Tax Act and Income Tax Act have been amended to include this tax incentive to maintain or create employment. The fact that this measure is applicable exclusively to resident taxpayers creates certain doubts as to its compatibility with the Community freedom of establishment and tax treaty principle of non-discrimination of permanent establishments (PE) of non-resident companies operating in Spain. This paper describes the unequal tax treatment given to PE of non-resident companies or individuals that operate in Spain since, although they are in the same situation and carry out the same activities, they cannot take advantage of this new tax incentive to create jobs that is applicable only to resident taxpayers. In my opinion, in order to avoid unjustifiable discriminatory tax treatment, the Spanish legislator should extend this tax incentive to PE that operate in Spain and create employment.

2. Tax Incentive for Resident Entities that Create Employment: A Reduced Tax Rate

Section 77 of Act 26/2009 adds the 12th Additional Provision to the Consolidated Version of the Corporate Tax Act passed by Royal Decree 4/2004 of 5 March, under which a reduced corporate tax rate is applied for maintaining or creating employment. Specifically, a reduced tax rate is envisaged for companies with a net turnover of less than EUR 5 million and a mean number of employees of between one and twenty-five, which maintain jobs, for tax years starting on 1 January 2009. The essential requisite is that, during the twelve months following the start of each tax year, the mean number of employees of the company is not less than one and not less than the mean number of employees during the twelve months prior to the start of the tax year.

If these conditions are met, the incentive consists in the application of a tax rate of 20% to the first EUR 120,202.41 of the tax base and a rate of 25% to the rest.[1] The general corporate tax rate in Spain is 30%. In addition, there is a special tax system for small and medium-sized enterprises under which such companies pay a progressive tax rate starting at 25% on profits of up to EUR 120,202.41 and 30% on the rest of the tax base. Therefore, this tax concession consisting of a reduced tax rate of 20% and 25% is undoubtedly of importance since it implies a significant advantage for all companies resident in Spain, irrespective of whether they pay the general tax rate or the special rate for small and medium-sized enterprises.

PE of non-resident companies that operate in Spain are taxed in accordance with the Non-Residents' Income Tax Act (NRITA) rather than the Corporate Tax Act. Since the legislator has not envisaged this incentive in an analogous rule of the NRITA, it may be held to be inapplicable to PE that operate in Spain. Under the NRITA, PE are considered equivalent to resident companies only for the purpose of

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1 This measure is analysed in J. Aneiros Pereira, 'El nuevo incentivo para el mantenimiento del Empleo: El Tipo De Gravamen Del 20 Por Ciento En El Impuesto Sobre Sociedades', *Crónica Tributaria & Boletín de Actualidad*, no. 1 (2010): 5–12.

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determining their tax base since only in this case is reference made to the Corporate Tax Act.[2] There is no similar reference to the Corporate Tax Act in relation to the tax rate applicable to PE, which pay the tax rate envisaged in section 19 NRITA.[3] Nevertheless, it should be remembered that the 2nd Additional Provision of the NRITA envisaged a progressive reduction in the tax rate, in line with the same reduction in the corporate tax rate, from 2007 (32.5%) to 2008 and successive tax years (30%). However, there is no such express provision regarding the new 2010 reduction in the tax rate for maintaining or creating employment, which is subsequent to that envisaged in the 2nd Additional Provision NRITA and, in addition, more generous (20% and 25%). We therefore consider that this reduction is not applicable to PE of non-resident companies that operate in Spain. An express provision in the NRITA would be necessary[4] in order to apply this reduction to PE, mainly of non-resident companies but also of non-resident individuals.

The fact that this tax incentive is not applicable to PE raises the question of whether it constitutes an infringement of the non-discrimination principle that alters and limits the freedom of establishment.[5] In general, the principle of non-discrimination has had a significant impact on the Spanish tax system, mainly in relation to direct taxes, and in particular on PE.[6] The case we shall now analyse is, in our opinion, an example of this type of discrimination, which is prohibited both under the non-discrimination of PE clause envisaged in double taxation treaties and pursuant to the Community principle of non-discrimination.

3. Discrimination in the European Union: Considerations in the Light of ECJ Case Law Concerning Freedom of Establishment

As is well known, based on freedom of establishment (Article 49 Treaty on the functioning of the European Union, ex Article 43 Treaty Establishing the European Community), the situation of PE is similar to that of resident companies. This means that companies have the right to set up either a subsidiary or a PE without suffering any type of discrimination based on the form chosen. The lack of legal personality of PE, as opposed to resident subsidiaries, should not be a reason for any differences in tax treatment.[7]

The European Court of Justice (ECJ) case law is quite clear in this respect and analyses the effect of certain national tax measures on freedom of establishment, taking as reference the comparable nature of the situation in which resident and non-resident companies find themselves. Discrimination is prohibited not only in identical situations but also in comparable situations in which the reason for the tax measure concerned is the same. Moreover, the Court has held that a measure would be discriminatory and contravene freedom of establishment when there is no sufficient justification for a difference in treatment. Broadly speaking, two aspects should be examined in order to decide whether or not the tax measure analysed is discriminatory: the comparability of the situations and the existence of justification for the difference in treatment.

In general, in this respect, it may be held that since the Corporate Tax Act provisions are applied to PE when taxing their profits, the comparability of resident companies and PE is recognized. In other words, it may be objectively deduced that there are no great differences between the two since both are obliged to pay tax, in similar conditions, on their profits, taking into consideration their worldwide income, regardless of where it is obtained.[8] The similarity exists not only in relation to their tax base but also the taxable event. This should logically mean that PE may likewise take advantage of the same tax advantages or incentives as do resident companies.[9]

Regarding the application of a reduced tax rate of 20% and 25% in the cases envisaged, it should be agreed that the comparison should be made between companies that maintain or create jobs and those that do not, regardless of whether or not they reside in Spain. Bearing in mind the origin and *ultima ratio* of this incentive, we consider that, for the purpose of applying it, the comparability between companies that are capable of maintaining or creating employment in certain conditions, rather than that between resident and non-resident companies, should be considered. From this point of view, it is obvious that both resident companies and PE of non-resident companies may maintain and create employment in order to foment production in

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2 Section 18 Royal Legislative Decree 5/2004 of 5 Mar. passing the Consolidation Version of the Non-Residents' Income Tax Act (NRITA): 'The tax base of a permanent establishment shall be determined pursuant to the general corporate tax regime'.

3 Section 19 NRITA: a tax rate of 35% shall be applied to the tax base determined in accordance with the previous section.

4 Either in this 2nd Additional Provision or in a specific provision of the Non-Residents' Income Tax Act.

5 Some authors consider that this measure does not affect freedom of establishment based on the argument that lower tax rates exist in the European Union and similar measures in other states (Aneiros, 6). In our opinion, the comparability that should be applied to analyse any restriction on the freedom of establishment imposed by this measure implies comparing the permanent establishments (PE) in Spain with companies resident in Spain and not comparing resident companies in Spain with companies resident in other Member States. In addition, the fact that other similar measures exist adopted by other states does not provide any element of analysis in relation to whether these measures are in agreement with either double taxation treaties or the EU Treaty.

6 A. García Prats, 'The Potential Impact of the EC Non-discrimination Principle on Spanish Income Taxation', *EC Tax Review* 3 (1998): 176–186.

7 Falcón y Tella & Pulido Guerra, *Derecho Fiscal Internacional* (Madrid: Marcial Pons, 2009), 178.

8 Section 15.1 NRITA, 'taxpayers who obtain income through a permanent establishment in Spain shall pay tax on all the income attributed to such establishment, irrespective of the place where it is obtained'.

9 J.M. Iglesias Casais, *No discriminación fiscal y Derecho de establecimiento en la Unión Europea* (Pamplona: Aranzadi, 2007), 278.

times of crisis and thus activate the economy. The effect on employment would be the same, irrespective of the legal form chosen to carry on the economic activity and the residence of the company; hence, a tax incentive consisting of reduced corporate tax rates should be applied to PE.

The idea that PE should not be discriminated against as compared with resident companies abounds in the case law of the ECJ.[10] In all cases, the Court holds that if a company that exercises its freedom of establishment is in a comparable situation to that of a company resident in the state in which it operates through a PE, the tax rules of that state should ensure that both companies (resident and non-resident) are treated the same, which means that the tax incentives envisaged for residents should be extended to non-residents that are in a comparable situation.[11] Undoubtedly, the judgment of the ECJ issued on 29 April 1999 in the *Royal Bank of Scotland* case is the one that best illustrates the doctrine that could somehow be applied to the measure analysed. In this judgment, the Greek rule under which a higher tax rate was applied to branches of foreign banks than that applied to resident companies was analysed. The court held that a PE was in the same situation as regards taxation of its profits as a Greek company and so different tax treatment could not be applied. The tax rate imposed on a PE should be the same as that levied on a resident company provided that there were no objective differences between the two.[12] The key to the legal arguments of the ECJ resides in the fact that although it is generically possible to recognize certain differences between residents and non-residents:

> it is not sufficient simply to state that residents and non-residents are in a different situation and may thus be taxed differently. It is necessary in respect of each tax advantage to determine whether there is a relevant difference between them, such as to provide objective justification for a specific difference in treatment.[13]

In view of this, we believe that the measure analysed may be contrary to freedom of establishment since it is discriminatory in comparable situations when the same tax treatment should be given to PE and resident companies, both in respect of the applicable tax rate and in application of tax credits and benefits. In this respect, we share the opinion of those who consider that application of the special regime under which small companies with up to a certain turnover pay a reduced rate of 25% when they are resident (including subsidiaries of foreign companies) should be extended to PE of companies resident in other Member States;[14] otherwise, it would be contrary to the Community freedom of establishment.

Given the difference in treatment, it should be evaluated whether or not there is sufficient cause to justify tax rules that are contrary to the freedom of establishment. Some of these causes may be found in the ECJ case law. The ECJ has held that some causes do not justify such measures, whereas others do reasonably justify a difference in tax treatment. The first include lack of harmonization of direct taxation,[15] possible loss of or reduction in tax revenue,[16] promotion of a country's economy based on investment in companies with their headquarters therein,[17] compensation of discriminatory treatment with other possible advantages for the PE[18] or the need to guarantee tax controls and prevent tax evasion.[19] None of these causes were considered sufficient to justify a difference in treatment. On the other hand, the need to have a territorial connection with the state that provides the tax measure[20] or the need to maintain coherence of the tax system[21] was considered sufficient to justify a difference in treatment. In the case being analysed, none of these causes could, in our opinion, justify not applying reduced corporate tax rates to PE of non-resident companies

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10 For example, the judgment of the ECJ issued on 28 Jan. 1986 in the *Avoir fiscal* case C-270/83, in which the court held that a measure that granted a deduction for corporate double taxation only to resident companies that obtained dividends and not to PE of non-resident companies was contrary to freedom of establishment. Vid: among others; judgments of the ECJ issued on 13 Jul. 1993 in the *Commerzbank* case C-330/91; 15 May 1997, *Futura* case C-250/95; 21 Sep. 1999, *Saint Gobain* case C-307/97; 14 Dec. 2000, *AMID case* C-141/99; 23 Feb. 2006, *CLT-UFA SA* case C-253/03; 28 Feb. 2008, *Deutsche Shell* case C-293/06; 15 May 2008, *Lidl* case C-414/06; 23 Oct. 2008, *Krankenheim* case C-157/07.

11 T. O'Shea, 'Freedom of Establishment Tax Jurisprudence: *Avoir Fiscal* Re-visited', *EC Tax Review* 6 (2008): 270.

12 The recent judgment of the ECJ issued on 6 Oct. 2009, Case C-562/07, *European Commission v. Kingdom of Spain* may be mentioned as an example of a pronouncement of the court concerning discrimination in the application of tax rates. Although it was not a case concerning discrimination of PE, the Court gave judgment against Spain for having legislation (until 1 Jan. 2007) under which capital gains of non-resident taxpayers were taxed at a rate of 35%, whereas in the case of residents, the applicable rate was 15% when the elements of capital had been owned for more than a year and a progressive rate of 15% to 45% when owned for less than a year. The Court held that in this case and in a comparable situation, non-residents were subject to, in certain cases, a higher tax burden than that born by residents, which was contrary to the free movement of capital. Moreover, the court held that this difference in treatment was not justified by the need to preserve coherence of the tax system.

13 R. Lyal, 'Non-discrimination and Direct Tax in Community Law', *EC Tax Review* 2 (2003): 70.

14 Falcón y Tella & Pulido Guerra, 178.

15 ECJ judgment of 28 of Jan., *Avoir fiscal* case; ECJ Judgment of 21 Sep. 1999, *Saint Gobain* case.

16 ECJ judgment of 21 Sep. 1999, *Saint Gobain* case.

17 ECJ judgment of 6 Jun. 2000, *Verkoojen* case C-35/98.

18 ECJ judgment of 28 Jan. 1986, *Avoir fiscal* case.

19 Although this last justification is possible, the ECJ has never applied it since the Court holds that the efficacy of tax controls cannot justify discriminatory measures and that Community directives on mutual assistance and exchange of information make it possible to adequately guarantee cross-border tax control and reduce the risk of tax evasion.

20 The ECJ in its judgment issued on 15 May 1997 in the *Futura* case implicitly declared that the existence of a rule under which the compensation for losses sought by a non-resident company with a branch in another state was conditional on such losses bearing an economic relationship with the income obtained by the taxpayer in that state was not contrary to the principle of freedom of establishment.

21 ECJ judgment of 28 Jan. 1992, *Bachmann* case C-204/90 and *Comisión/Bélgica* case C-300/90.

that maintain or create employment in Spain in the terms laid down in the relevant legislation.

4. Non-Discrimination of Permanent Establishment Clause in DTT (Article 24.3 OECD MC)

This clause does not allow PE to be discriminated against in matters of taxation of their business activities as compared with resident companies in the same sector. The purpose of this clause is to prevent contracting states from envisaging tax measures that make resident companies more competitive than non-resident companies operating in their territory through a PE.[22] Comparability is considered to exist when the companies involved fulfil similar subjective conditions. Hence, the PE of corporations are compared with corporations and those of partnerships with entities subject to the income allocation regime.[23] Under this article, less favourable taxation than that applied to domestic companies carrying on the same activities may not be imposed on a PE. It does not prohibit a different tax system but rather the levy of a more burdensome tax on PE than that levied on resident companies. We believe that, in order to determine whether less favourable taxation exists, the tax burden of the non-resident company – which operates through a PE – in its state of residence should not be taken into account. A difference in treatment in procedural aspects would not be discriminatory, nor even the levy of a different tax if it does not imply less favourable taxation, and this should be determined on a case-by-case basis. In the case considered, since basically the corporate tax legislation is applied to determine the tax base of the PE, not applying the reduced tax rates for maintaining or creating employment to PE would indeed mean less favourable taxation of the latter as compared with resident companies. In some cases, it has been understood that the unique nature of special tax regimes does not allow certain tax advantages to be extended. For example, Vogel considers that under Article 24.3 OECD Model Convention on Double Taxation, it is not possible to extend tax incentives or special regimes enjoyed by certain non-profit entities – foundations – and public entities of the state in which the PE is located to the latter.[24]

One of the questions to be considered is how to define a 'comparable situation'.[25] It has been suggested that it implies a similarity in each detail that may be considered a relevant factor in a specific legal or factual situation. The problem of interpretation arises again when determining what factors should be considered relevant in a specific situation[26] and what is more important – should it be left to the courts to decide the comparability case by case?[27] A comparable situation implies considering elements that are 'substantially' but not 'formally' the same. The primacy of a substantial over a formal analysis is essential when determining whether or not there is discrimination.[28] With regard to the comparability in our case, it is evident that a PE must carry on the *same activities* as the resident company in order to avoid less favourable taxation. The PE must belong to the same sector of economic activity or carry on the same type of activities as a resident company. In the case being analysed, the tax incentive is applied to all legal persons that are corporate tax payers and does not refer to any economic sector in particular or any specific activity. Therefore, the PE that carries on any type of economic activity in Spain would be in a comparable situation to that of a company resident in Spain. Of course the legislator may provide tax incentives or credits for certain economic sectors (e.g., the automobile sector) or for certain activities (creation of employment, R+D+i activities), and this is not contrary to the non-discrimination clause in Article 24.3 OECD MC, provided that the PE operating in the state is allowed access to the same reductions in the same circumstances and conditions. In the case considered, a reduced tax rate for any type of company that creates employment should be extended to PE that operate in Spain and create employment because the situation is comparable and, in this sense, 'the same activities' would be carried on as laid down in Article 24.3 OECD MC. It does not seem logical that the terms of comparison should refer exclusively to resident companies that carry on domestic operations; they should also include companies that carry on international operations and create employment in Spain.[29]

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22 K. Van Raad, *Non Discrimination in International Tax Law* (Deventer: Kluwer, 1986), 127.

23 Nevertheless, there is a certain leeway regarding difference in treatment between PE and resident companies although this does not automatically imply application of a different legal system. Art. 24.3 OECD MC attempts to solve the problem and prevent such discrimination (F. Serrano Antón, 'La tributación de los no residentes mediante establecimiento permanente', en *Internacionalización de las inversiones*, dir: Collado Yurrita (Bosch: Luchena Mozo y Sánchez López, 2009), 668).

24 K. Vogel, *Double Taxation Conventions* (Boston: Kluwer, 1997), Art. 24, para. 124.

25 For A.P. Dourado, 'From the *Saint Gobain* to the *Metallgesellschaft* Case: Scope of Non-Discrimination of Permanent Establishments in the EC Treaty and the Most-Favoured-Nation Clause in EC Member States Tax Treaties', *EC Tax Review* 3 (2002): 148, 'the meaning itself of equal treatment of permanent establishments in relation to subsidiaries is not unambiguous in international tax law'.

26 In the opinion of C. Peters & M. Snellaars, 'Non-discrimination and Tax Law: Structure and Comparison of the Various Non-Discrimination Clauses', *EC Tax Review* 1 (2001): 14, it is the purposes and objectives of the specific potentially discriminatory tax rule that will determine whether or not a certain circumstance or activity is discriminatory.

27 B. Santiago, 'Non Discrimination Provisions at the Intersection of EC and International Tax Law', *European Taxation* 5 (2009): 254. This author proposes considering 'a hypothetical situation that has the similarities required by the provision in question with the real situation', to be a similar situation 262.

28 Dourado, 152.

29 Calderón et al., *Comentarios a Los Convenios Para Evitar La Doble Imposición Y Prevenir La Evasión Fiscal Concluidos Por España* (Fundación Pedro Barrié de la Maza: Instituto Estudios Económico de Galicia, 2005), 1129.

The Committee on Fiscal Affairs refers to tax incentives that the states adopt to solve specific problems, such as decentralization of industry, development of more economically backward regions, or promotion of new activities necessary to expand the economy.[30] All these incentives, in the opinion of the Committee on Fiscal Affairs, should be extended to the PE of companies resident in another state if there is a double taxation treaty that includes the non-discrimination clause envisaged in Article 24 OECD MC and this PE is authorized to carry on its activities in the state in question. Therefore, the PE should be allowed to enjoy such tax incentives provided that it fulfils the conditions laid down in the relevant legislation in the same terms as do resident companies. Nevertheless, it is obvious that the principle of non-discrimination does not make it compulsory to extend to the PE of non-resident companies tax incentives that are strictly reserved for certain companies due to national interest, defence, protection of the domestic economy, and so forth, since the PE of foreign companies would not be authorized to carry on such activities.[31]

From the OECD MC, it may be deduced that the structure and type of tax rate applicable to resident companies should be applied to PE pursuant to Article 24.3 OECD MC. Some doubts may arise as to the types of specific or special tax rates applicable to certain resident companies and not to a PE. The difficulties may reside in the fact that the PE is only a part of a legal person that is not subject to the jurisdiction of the state in which the PE is located. Nevertheless, it is understood that if the PE carries on the same activities as the resident companies to whom a specific tax rate is applied, then the same tax rate should be extended to the PE.[32]

The Committee on Fiscal Affairs of the OECD has declared that the rules providing a progressive tax rate for resident companies are applicable to PE based in that state, and for this purpose, the profits obtained by the company of which the PE forms part are taken into account, and this is not contrary to Article 24.3 OECD MC.[33]

In any case, the hybrid nature of PE makes it difficult to apply the non-discrimination principle. In the case of application of progressive tax rates, under the Double Tax Treaty (DTT) between Spain and Belgium, a PE may be taxed at the maximum rate envisaged for resident companies and this poses no problems with the non-discrimination principle. On the other hand, the DTT with India provides that it is not contrary to the non-discrimination principle to tax a PE at a higher rate than that applicable to a resident company.

Most of the Spanish DTT contain this non-discrimination of PE clause and, in general, follow the precept of the OECD MC. Only the DTT with India provides, for the purpose of non-discrimination, that a PE of a contracting state shall be compared, not with companies resident in the state where the PE is located but with other PE of companies resident in a third state, thereby configuring a kind of 'most favoured permanent establishment' clause.

The Spanish authorities have interpreted non-discrimination of PE in relation to application of the Spanish tax system for joint ventures to PE based in Spain. The authorities consider that verification of the existence of less favourable taxation should be analysed case by case and that it is not contrary to Article 24.3 OECD MC to give different tax treatment to non-residents and residents. In this specific case, the authorities understand that since it is not possible to compensate the losses generated by the branch with the profits of the joint venture, it is difficult to compensate profits and losses in the joint venture in which it participates. This results in less favourable taxation than that which would arise from participation in the joint venture of entities resident in Spain and so produces discrimination prohibited under the DTT.[34] In cases in which it is not possible to verify that a more burdensome taxation is actually imposed on the PE, application of rules to the PE that are different to those applied to resident companies does not constitute discrimination prohibited under tax treaties.[35]

The Spanish Supreme Court held – mistakenly in the opinion of Spanish authors, with whom we agree – that the Spanish rule that prevented a PE from acting as the dominant company in a tax consolidated group was not discriminatory. The only argument of the Supreme Court, which is debatable, was that under Spanish rules, only public limited companies resident in Spain may avail themselves of the tax consolidation regime.[36] Nevertheless, we believe that it is obviously more burdensome for a PE to be prevented from heading a consolidated group in Spain than to be allowed to head such a group since in the latter case, it would be possible to compensate losses between members of the group, which would reduce the tax burden. The Supreme Court compares the PE of a non-resident company with other Spanish establishments lacking legal personality and argues that tax treatment in relation to tax consolidation is the same in these two cases since it is not comparable with the treatment given to companies in Spain. The Court

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30 Paragraph 43 of the Comments on Art. 24 OECD MC.

31 Paragraph 46 of the Comments on Art. 24 OECD MC.

32 Calderón et al., 1129.

33 Paragraph 57 of the Comments on Art. 24.3OECD MC.

34 Enquiries to the Directorate General for Taxation (DGT) 23/2005 of 28 January (DTT Spain-France) and 25/2005 of 29 January (DTT Spain/Belgium).

35 DGT enquiries 635/2002 of 26 April (DTT Spain-Denmark) and Binding Enquiry V1089/2005 of 14 Jun. 2005 (DTT Spain-Italy).

36 Judgments of the Supreme Court issued on 15 Jul. 2002 and 12 Feb. 2003.

makes the mistake of comparing a PE with other entities lacking legal personality in Spain, when under Article 24.3 OECD MC, a PE should receive the same treatment as that given to Spanish companies that carry on the same activities. This has been clearly interpreted by experts and shows the mistake made by the Court as regards the objects of comparison in the principle of non-discrimination.[37] For this reason, as well as in view of the ECJ case law, the Spanish legislator modified the Corporate Tax Act rule and now authorizes a PE to act as the dominant company in a tax-consolidated group in Spain.

Given the existence of two interpretations of non-discrimination, that is, Article 24 of Tax Treaties and EC law, the question has arisen as to whether double taxation treaties between Member States should be interpreted following the ECJ case law or whether they are two different frameworks that may coexist. In this sense, we share the opinion that although it is not necessary to harmonize the non-discrimination provisions in the tax treaties and EC law because the two have different objectives and different sources of interpretation and, moreover, there is no real conflict between the two sets of rules, the truth is that this does not mean that the interpretation of the ECJ should not be taken into account when interpreting the non-discrimination provisions of a double taxation treaty. Quite the opposite, it is advisable to be aware of and take into consideration the interpretation of the ECJ in such cases.[38]

In this respect, the Luxembourg Court has demonstrated the divergence of interpretations of the non-discrimination of PE clause, with the result that, on some occasions, its interpretation is insufficient to satisfy the demands of freedom of establishment – see the judgment in the *Wielockx* case, in favour of a PE (natural person), concerning non-recognition of the deductibility of certain contributions made. In other cases, the ECJ held that even in application of the same rules – the requisite of separate accounting for the PE under the legislation applicable to resident companies, for the purpose of demonstrating the existence of losses so as to be able to compensate for such losses – there is a restriction on the freedom of establishment given that this requisite implies an additional financial burden for non-resident companies with a PE since they must draw up their accounts pursuant to two different legislations – *Futura* judgment.[39]

5. Tax Incentive for Resident Natural Persons Who Create Employment: Tax Base Reduction

The incentive to maintain or create employment for natural persons resident in Spain consists in applying a 20% reduction in income tax on the net income from economic activities.[40] In order to apply this reduction, a natural person must exercise a self-employed economic activity, have a turnover of less than EUR 5 million, have a mean number of employees of less than twenty-five, and, moreover, maintain or create employment. Once again, this measure is applicable exclusively to resident natural persons who carry on self-employed economic activities and, therefore, is not applicable to the PE of non-resident natural persons given that the tax base of a PE based in Spain is always determined pursuant to corporate tax rules.[41] These rules do not envisage any reduction in the tax base but simply a type of reduced tax, as seen above, that is not applicable to PE. Therefore, since the PE of non-resident natural persons determine their tax base pursuant to corporate tax rules, they cannot take advantage of a 20% reduction in their tax base because the income tax legislation is not applicable when determining the tax base of non-resident natural persons who operate through a PE.

With regard to this question, it should be remembered that the second phrase of Article 24.3 OECD MC limits positive discrimination by indicating that natural persons who operate through a PE shall not take advantage of personal or family tax credits or deductions granted to residents since the state of residence and not the state in which the PE is located should adapt such circumstances to the taxpayer's ability to pay, thereby preventing a double benefit from being obtained in the two states. The provision attempts to ensure that natural persons who operate through a PE in another state do not obtain greater advantages than do the residents in this other state by applying personal and family deductions twice, once in the state of residence of the natural person – in application of domestic rules, and again in the state in which the PE operates – in application of the principle of non-discrimination in tax matters.[42] However, the tax treaties signed by Spain with Morocco and Switzerland allow the opposite and ensure that the nationals of a state subject to taxation in the other state may take advantage in the latter of the tax benefits and exemptions granted

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37 A. García Heredia, 'La discriminación de establecimientos permanentes de sociedades de otros Estados miembros. A propósito de la STS de 12 de febrero de 2003', en *Aranzadi Jurisprudencia tributaria* 10 (2003): 33–49.

38 B. Garrido, 'Interaction between the Interpretation of the Non-Discrimination Provisions in Tax Treaties and in the EC Treaty: An Apparent Rather than Real conflict', *EC Tax Review* 4 (2009): 178. In this sense, in Ph. Hinnekens, 'Non-Discrimination Art. in OECD Model Convention Needs Fundamental Review', *EC Tax Review* 6 (2008): 249, considers that ECJ case law should be a source of inspiration to propose a new legal framework for the new non-discrimination article of the OECD Model Convention, even though tax treaties and EC law pursue different objectives because they understand that the interpretation of the ECJ has contributed to the successful, uniform development of this principle of non-discrimination in EC law.

39 A. García Prats, 'La cláusula de no discriminación en los Convenios para evitar la doble imposición internacional', *Fiscalidad Internacional*, 3ª edición (Madrid: CEF, 2010), 1090.

40 Section 72 of the General State Budgets 2010 Act (Act 26/2009 of 23 December) includes a 27th Additional Provision to the Natural Persons Income Tax Act (Act 35/2006 of 28 November).

41 Section 18 NRITA.

42 Paragraph 36 Comments on Art. 24 OECD MC.

for families in the same conditions as nationals of the first state. In any case, application of a reduction in the tax base for natural persons who maintain or create employment does not appear to be considered a personal or family incentive; thus, under Article 24.3 OECD MC, this business incentive would be applicable to PE of non-resident natural persons.

On the other hand, it should be noted that natural persons resident in a Member State of the European Union who own a PE and obtain more than 75% of their income in Spain may apply section 46 of the NRITA[43] and opt for paying tax in Spain as though they were residents applying the natural persons' income tax rules. In such a case, the 20% reduction in tax on the net income from economic activities for maintaining or creating employment would be applicable, taking into account the legislation envisaged for residents. Otherwise, that is, if it were not possible to exercise the option envisaged in section 46 NRITA and for other individuals resident in a third state that operate through a PE, discrimination in the terms analysed would persist since it would not be possible to apply the 20% reduction in the tax base of PE that create or maintain employment.

Note

[43] Section 46 NRITA, 'A taxpayer who is a natural person resident in a Member State of the European Union, provided that he proves he has fixed his habitual residence or domicile in a Member State of the European Union, and has obtained in Spain during the tax year at least 75% of all income from earnings and economic activities, may opt for paying natural persons' income tax provided that during this period non-residents' income tax has effectively been levied on such income'.