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The International Comparative Legal Guide to:

Corporate Tax 2007

A practical insight to cross-border Corporate Tax work

Published by Global Legal Group with contributions from:

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1 General: Treaties

1.1 How many income tax treaties are currently in force in your jurisdiction?

There are sixty eight tax treaties currently in force in Spain (please note that the USSR-Spanish Treaty applies to all Republics of the former USSR, except Estonia, Latvia and Lithuania who have entered into new treaties with Spain). In addition, there are thirteen tax treaties pending to be exented or published in the Spanish Official Gazette, and approximately, fifteen treaties which are under negotiation. The tax treaties signed by Spain cover almost all EU Member States (except for Cyprus - this is under negotiation) and all the other OECD members. In addition, Spain has a wide network of treaties with Latin American countries. An updated status of all income tax treaties and its Spanish version can be found at: http://www.minhac.es/Portal/Normativa+y+doctrina/Normativa/CDI/CDI_crono.htm

1.2 Do they generally follow the OECD or another model?

Tax treaties signed by Spain generally follow the OECD model.

The Spain-US treaty is closer to the US Model. At present, the Spanish-Swiss tax treaty does not include the exchange of information clause which implies some tax drawbacks for residents in Switzerland. This last treaty has been renegotiated and is pending approval by the Spanish Parliament.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

The Parliament's authorisation is required to execute an income tax treaty; in addition, the implementation of tax treaties in domestic law requires its publication in the Spanish Official Gazette.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

Most treaties which are currently in force do not include "limitation of benefits" clauses. However, this policy has changed after the Spanish-US tax treaty was executed in 1990; this treaty includes the first "limitation of benefits" clause in a Spanish treaty. Thereafter, most of the new treaties signed by Spain include a "limitation of benefits" clause.

The "limitation of benefits" clause usually restricts treaty benefits, *inter alia*, to (i) income obtained in the other country if it derives from an active trade or business in the country of residence; (ii) a company that has substantial and regular trading of its stock on a recognised securities exchange; and (iii) companies which have more than 50% of the share capital owned by persons who are entitled to treaty benefits and whose gross income is not substantially used to meet liabilities with qualified persons or entities.

Spanish Tax Authorities require a specific certificate issued by the tax authorities of the taxpayer's country of residence stating that, to the best of their knowledge, the person requesting the certificate is entitled to treaty benefits. A certificate of residency is required in order to claim an exemption or a reduced tax rate. The said certificate is valid for twelve months from the date of issuance.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

Tax treaties which have been implemented in domestic law cannot be superseded by any existing or subsequent domestic laws. If a conflict between a provision of a tax treaty and other domestic law, other than the Spanish Constitution, occurs the tax treaty prevails.

The provisions established in the tax treaties can only be abolished, modified or suspended in accordance with the system established in the treaties or in accordance with the general rules of international law.

2 Transaction Taxes

2.1 Are there any documentary taxes in your jurisdiction?

Stamp Duty (*"Impuesto sobre Actos Jurídicos Documentados"*) is levied on:

- The granting of notarial deeds with a valuable object, provided that the deed can be registered with the Commercial Registry, the Land Registry, the Industrial Property Registry or the Moveable Assets Registry. Tax rates range from 0.5% to 2%.
- The issue of bills of credit, promissory notes and other draft documents in those cases when the document implies a transfer of funds (*"función de giro"*). A document meets this requirement if (i) it evidences the transfer of funds; (ii) it implies a payment order; or (iii) it is issued "to the order" of the receiver (*"a la orden"*). The tax due is determined by applying a sliding scale to the face amount of the document.

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- The issue of certain administrative documents.

Capital Duty (*"Impuesto sobre Operaciones Societarias"*) is levied on certain corporate transactions such as the incorporation, increase of share capital, merger, split-off, winding-up, or share capital reduction of Spanish entities. The tax is generally paid by the company benefiting from the transaction, at a 1% tax rate. Capital Duty is levied on the shareholders in the event of share capital distributions.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

VAT rates depend on the type of goods delivered or services provided. The standard rate is 16%; a 7% reduced tax rate is applicable, *inter alia*, to sport activities, food, health products, housing, entertainment services, hotels and restaurants, or agricultural services; and a 4% super-reduced rate applies, *inter alia*, to some essential goods and books.

Please note that new VAT grouping rules have been introduced as of 1 January 2007.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

As a general rule, VAT is levied on transfers of goods made or services provided by entrepreneurs, on certain intra EU acquisitions and on the import of goods. Please note that in the Canary Islands, Ceuta and Melilla (Spanish cities in northern Africa) no VAT is exacted. In these territories, special indirect taxes are levied.

Goods are generally deemed to be supplied in Spain if transfer of ownership takes place in Spain. Services are deemed to be provided in Spain if the provider has its place of business in Spain, with certain exceptions - such as *inter alia* legal, financial, advertising or consulting services.

Acquisitions from other EU countries are subject to a special regime: normally, VAT is paid in the "country of origin" in connection with non-commercial intra-EU transactions, whereas VAT is levied in the country of destination on commercial intra-EU transactions.

The transfer and provision of certain goods and services, such as certain transfers of real estate, financial transactions or the transfer of securities are exempt from Spanish VAT.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Taxable persons charging VAT on their transactions are entitled to deduct the tax borne within a taxable period ("input VAT") from the tax collected ("output VAT") within the same period. Any excess of output VAT must be paid to the tax authorities; and any excess of input VAT can either be set off against future output VAT or refunded at the end of the next fiscal year (end of the calendar year).

In this regard, a taxpayer supplying a combination of both exempt and taxable goods or services is normally entitled to recover a pro rata of input VAT.

Finally, please note that Spanish VAT Law establishes a special procedure under which taxpayers not established in Spain can obtain a refund of the VAT borne on the transactions performed by them within a taxable period. This VAT refund is limited to States (other than EU members) whereby reciprocity can be evidenced. The Spanish Tax Authorities have recognised such reciprocity with Canada, Japan, Monaco, Norway and Switzerland.

2.5 Are there any other transaction taxes?

Transfer Tax (*"Impuesto sobre Transmisiones Patrimoniales"*) is levied on the transfer of rights and assets located in Spain as well as on the creation of security interests and other rights *in rem*, provided that such transactions are not subject to Spanish VAT (normally if no entrepreneur is involved in the transfer or in a VAT-exempt real estate transaction). Transfer Tax on the transfer of real estate is levied at different rates depending on the Autonomous Community where the land is located. If no specific rate is set forth, a 7% rate is levied on the value of the real estate. Transfer Tax is not recoverable.

Transfer Tax on real estate is also levied on transfers of shares or participations in the share capital of entities in which more than 50% of its assets is composed of real estate located in Spain, provided that, as a result of such acquisition, the acquirer holds, directly or indirectly, more than 50% of the share capital of the entity. Other anti-abuse provisions exist.

2.6 Are there any other indirect taxes of which we should be aware?

Certain products (such as alcoholic drinks, tobacco, electricity, hydrocarbons, etc.) and services (power, insurance transactions), as well as the registration of certain vehicles are subject to special indirect taxes (*"Impuestos Especiales"*) in Spain.

3 Cross-Border Payments

Withholding tax in Spain is, generally, a payment in advance of the final income tax levied on the income. Therefore, the withholding rate will usually be equal to the applicable final tax rate. This means that where a non-resident taxpayer is entitled to an exemption or a reduced rate, a certificate of residence evidencing the taxpayer's right to the exemption or reduced rate should be furnished to the payer of income so that no withholding (or the corresponding reduced rate) is applied; otherwise, standard withholding tax rates will be applied and a refund will need to be sought afterwards. Such a certificate is valid for one year from the date of issue.

3.1 Would there be any WHT on royalties paid by a local company to a non-resident?

As a general rule, royalties paid by a company resident in Spain to a non-resident taxpayer are subject to withholding tax in Spain at a 24% rate or at the reduced rate provided for in the corresponding income treaty.

Please note that under the so-called EU Interest and Royalties Directive, royalties paid to a related company resident for tax purposes in an EU Member State other than Spain shall be exempt from withholding tax as of 1 January 2010 (for a transitional period; since 30 June 2004, such payments have been subject to a 10% withholding tax).

3.2 Would there be any WHT on interest paid by a local company to a non-resident?

As a general rule, interest paid by a Spanish resident company to a non-resident taxpayer is subject to withholding tax in Spain at a 18% rate or at the reduced rate provided for in the corresponding income treaty. However, interest paid to a resident in an EU Member State is exempt from withholding taxes, unless such

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interest is obtained through a tax haven country or jurisdiction or allocated to a permanent establishment in Spain. Other exemptions may be available for specific financial products (Treasury Bonds issued by the Kingdom of Spain).

3.3 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Yes. Under the Spanish thin capitalisation rules, interest payments to non-Spanish resident related parties for indebtedness in excess of three times the equity of the Spanish company are regarded as a dividend distribution for tax purposes. Therefore, such payments are treated as a non-deductible expense for Corporate Income Tax ("CIT") purposes and are subject to dividend withholding tax. The above notwithstanding, thin capitalisation rules do not apply to indebtedness vis à vis companies resident in other EU Member States which are not resident in a tax haven jurisdiction.

3.4 If so, is there a "safe harbour" by reference to which tax relief is assured?

Please refer to question 3.3 above. In addition, taxpayers may request a specific ruling raising the acceptable debt to equity ratio, based on fair market conditions. In the event that the Tax Authorities approve such a request, an Advance Pricing Agreement will be entered into for a 3-year period.

3.5 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Thin capitalisation rules apply to both direct and indirect indebtedness with non-resident related parties. Loans granted by a third party but supported by a related company guarantee have been construed by the Tax Authorities as an "indirect indebtedness"; some scholars do not agree with this interpretation of the Spanish Tax Authorities. It is clear that a back-to-back financing is regarded as indirect indebtedness.

3.6 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

As a general rule, dividends paid by a Spanish resident company to a non-resident are subject to withholding tax in Spain at an 18% rate or at the reduced rate provided for in an income tax treaty.

Under the EU Parent-Subsidiary Directive, as implemented in Spain, dividends paid to a company resident in the EU which holds a participation in a Spanish company equal to or higher than 15%, are exempt from withholding tax when such participation has been held for more than 1 year. This exemption is denied if the stake is directly or indirectly ultimately controlled by a non EU person or entity, unless the EU direct parent company evidences the active management of the participation or similar activities to those run by the Spanish subsidiary.

3.7 Does your country have transfer pricing rules?

The Spanish transfer pricing rules are based on OECD Transfer Pricing Guidelines. Therefore, the Spanish Tax Authorities are entitled to reassess all related party transactions to their fair market value and to recharacterise some transactions to their actual economic nature (i.e.: interest in excess of market interest rates may be recharacterised as dividends).

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The headline rate of CIT on corporate profits is 32.5% and will be reduced up to 30% for fiscal years staring as of 1 January 2008. Certain credit institutions and insurance companies are subject to a reduced 25% tax rate, whilst some collective investment institutions are subject to a 1% tax rate. Likewise, certain retirement funds are taxed at a 0% tax rate whereas some oil companies are taxed at a 37.5% (35% in 2008).

Finally, companies with a turnover in the previous year lower than EUR 6 million can apply a reduced tax rate of 25% for the first EUR 120,202.41 of their taxable base and 30% for the excess.

4.2 When is that tax generally payable?

Filing of CIT tax return (and payment of the final CIT liability)

CIT is payable during the first twenty-five calendar days following the six-month period after the end of the relevant fiscal year. Therefore, if the fiscal year coincides with the calendar year, CIT would be payable during the first 25 days of the month of July of the following year.

Interim advanced payments on account of CIT

During the first twenty days of April, October and December, entities subject to Spanish CIT make interim advance payments on account of the final CIT.

These interim payments are calculated by applying an 18% rate on the CIT tax liability corresponding to the last fiscal year for which a declaration has been filed. Under this form of calculation of interim payments, the taxpayer is entitled to deduct withholding taxes, but not previous interim payments made during the fiscal year.

If the taxpayer's turnover during the last fiscal year is higher than EUR 6,010,121.04, or if the taxpayer chooses this second alternative during the month of February of the relevant fiscal year, payments on account of CIT will amount to 25% of the taxable base of the third, ninth, and eleventh months of the relevant fiscal year. Under this second alternative, the taxpayer is entitled to credit withholdings taxes as well as previous advance payments for the relevant fiscal year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The CIT base is calculated by reference to the taxpayer's profit and loss account drawn up in accordance with the Generally Accepted Accounting Principles in Spain, as adjusted pursuant to the CIT Law which sets out fairly straightforward guidelines as to tax deductions and expenses.

Allocation of revenues and expenses

Allocation of revenues and expenses are generally made on an accrual basis both for accounting and tax purposes.

Expenses are not deductible unless they are correctly recorded in the profit and loss account. However, expenses recognised in the profit and loss account in a fiscal year later than their accrual period, or revenues recorded in a fiscal year before their accrual period, are deductible or taxable when recorded, provided this does not lead to a lower level of tax.

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Non-deductible expenses

Deductibility is expressly excluded for returns of equity, expenses arising from the accounting of the CIT itself, criminal and administrative fines and penalties and administrative collection surcharges and surcharges for late submission of returns. The CIT Law also includes a rule regarding the non-deductibility of expenses in connection with services performed by persons or entities resident in tax havens or paid through tax havens, unless evidence of the existence of the service is shown.

Provision for bad debts

Provisions made to cover the risk of possible debtor insolvency (including provisions for covering the so-called country-risk of credit institutions) are deductible if they refer to debts that remain unpaid after six months, or, in case of credit entities, provided that they have been booked in accordance with Bank of Spain's accounting rules.

Depreciation and amortisation of assets

Depreciation and amortisation expenses are deductible in respect of 'effective' depreciation due to operation, use, enjoyment or obsolescence during the useful life of the assets. All **fixed assets**, excluding land, are depreciated for tax purposes. Amortisation of goodwill, trademarks and other **intangible items** are also deductible for tax purposes, within certain limits. Generally, goodwill is considered to be a deductible expense, provided that it has not been artificially created in a transaction between related parties and provided that the transferor of the assets has been subject to tax on that goodwill.

Depreciation of **financial goodwill** (i.e., goodwill resulting from share acquisitions) is deductible in the context of certain acquisitions of shares representing the share capital of non-resident companies or some company mergers.

4.4 Are there any tax grouping rules?

A group of companies may be taxed on its consolidated tax base, provided that it notifies such choice to the Spanish tax authorities before the beginning of the fiscal year when it will file as a group. Only corporations resident in Spain or permanent establishments which hold participations or shares in resident companies which are related to their activity in Spain are eligible to belong to a tax group. In order to be eligible for tax grouping, among other conditions, the parent company of the group may not be owned by another company resident in Spain holding at least 75% of its capital and, in turn, the parent company must own at least 75% of the capital of its group subsidiaries prior to the first day of the fiscal year when the tax grouping regime is to apply.

4.5 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, although the method chosen for distribution of profits generated by a company resident in Spain is not neutral.

Tax treatment of distributed profits

Dividends obtained by a company resident in Spain are taxable, unless declared before the acquisition of the shares.

In order to avoid double taxation on dividends, a company resident in Spain is entitled to a 50% tax credit of the tax liability corresponding to the dividends received. This tax credit is raised to 100% when dividends derived from a participation of at least 5% have been uninterruptedly held during the year prior to the dividend record date. Any excess credit can be carried forward for seven years. Some restrictions apply.

Tax treatment of capital gains

Capital gains obtained by a company resident in Spain on the sale of a participation in a company resident in Spain are taxable. The transferor is entitled to a tax credit equal to 100% of the tax liability corresponding to retained earnings generated during the holding period on similar conditions.

4.6 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Valuation of assets

In general, only accounting valuation rules apply for tax purposes. However, discrepancies may exist due to specific valuation rules.

Fair market value transactions

The following assets must be valued at arm's length, regardless of their accounting treatment:

- those transferred or acquired without consideration;
- those contributed to entities and the securities received in exchange;
- those transferred to shareholders/partners on dissolution, withdrawal of shareholders, capital reduction with distribution of contributions and distributions of issuance premiums;
- those transferred pursuant to reorganisations; and
- those acquired by exchange or conversion.

Loss carry forwards

Tax losses are carried forward for 15 years. Newly-created entities may calculate such period from the first fiscal year generating a positive taxable base.

Tax credits

There are certain investment tax credits available, such as those related to export activities, reinvestment and R&D, as well as for investments undertaken in certain regions. These tax credits will be abolished in 2011.

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc.?

There are several excise taxes levied on specific products and services - alcohol, tobacco, power, gas, insurance; and on the production or import into Spain of some special products and goods.

4.8 Are there any local taxes not dealt with in answers to other questions?

The following local taxes are levied:

- Tax on Economic Activities (*Impuesto sobre Actividades Económicas*);
- Tax on Real Estate Property (*Impuesto sobre Bienes inmuebles*);
- Tax on Motor Vehicles (*Impuesto sobre Vehículos de Tracción Mecánica*);
- Tax on Construction and Installation Projects (*Impuesto sobre construcciones, instalaciones y obras*); and

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- Urban Land Appreciation Tax (*Impuesto sobre el Incremento de Valor de los Terrenos de Naturaleza Urbana*).

Some Autonomous Regions have capacity to enact its own Corporate Income Tax and Non Resident Income Tax (Basque Country and Navarre). Some regions have already enacted environmental taxes (Andalucía); taxes on large retail stores (Catalunya, Aragón or Asturias); or taxes on petrol retail sales - intended to finance the public health budget.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

In general terms, the Spanish CIT Law does not provide for any special set of rules for taxing capital gains and losses.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

No (see question 5.1 above).

5.3 Is there a participation exemption or relief for reinvestment?

Tax credit for reinvestment

A 12% tax credit for reinvestment is available if the price of a sale of fixed assets connected to business (including participations larger than 5% in the share capital of a company and held for more than a year) is reinvested in (i) tangible or intangible assets connected to the business; or (ii) stakes that represent more than 5% of the share capital of entities. The period during which the reinvestment should be carried out ranges from the year prior to the transfer of the stake until the end of three years following such transfer. The tax credit is applied in the fiscal year when the reinvestment takes place or, if such reinvestment is made before the transfer of the stake, in the fiscal year when such transfer took place.

Participation exemption

Dividends received from foreign subsidiaries and capital gains arising from the disposal of shares in such foreign subsidiaries are exempt from CIT. This regime is subject to the following requirements:

- a participation in the share capital equal to or higher than 5% (or a EUR 6,000,000 tax basis for a Spanish holding company -*ETVE*-);
- a minimum one-year holding period; and
- a foreign subsidiary subject to and not exempt from a tax of an identical or analogous nature to Spanish CIT, not resident in a tax haven, and engaged in an active trade or business carried out abroad.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

Capital Duty is payable upon the incorporation of a Spanish subsidiary and upon the establishment of a branch.

Upon the incorporation of a Spanish subsidiary, capital duty is payable at a 1% rate on the total share capital plus the issuance premium, if any. In the case of a branch, such rate is applied on the total capital allocated by the head office for the establishment and operation of the branch. However, an exemption applies if the head office is resident in an EU Member State, if it has been subject to a tax similar to Spanish Capital Duty in such territory.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No significant difference exists between branches and subsidiaries, other than on the calculation of the tax base and on distribution of profits.

6.3 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

A Branch Profit Tax is levied at a 18% rate on the profits transferred to the head office. Branch Tax is applicable unless (i) the head office is resident in an EU Member State; or (ii) the head office is resident in a country which has entered into a tax treaty with Spain, unless the treaty specifically considers Branch Tax.

6.4 Would a branch benefit from tax treaty provisions, or some of them?

Branches not established in Spain, generating Spanish source income, are only entitled to apply benefits deriving from the income treaty entered into by Spain and the country of residence of its head office, assuming that the head office is effectively entitled to treaty benefits.

6.5 How would the taxable profits of a local branch be determined?

The taxable base of a branch in Spain is calculated in a similar way as the tax base of a subsidiary.

However, fees, interest - except in the case of branches of financial institutions -, consideration for technical assistance or for the use of goods or rights charged by the head office or other permanent establishments are not, in general, tax-deductible for the branch. Management and administrative expenses are deductible by the branch in an amount "which can be reasonably attributed to the branch" provided that (i) they are recorded for accounting purposes; (ii) the allocation criteria is stated in an information memorandum; and (ii) the criteria are reasonable and consistent during the different fiscal years.

Tax credits for the avoidance of international double taxation are not available for branches.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No other tax or withholding tax is imposed on the distribution of profits (see question 6.3 above).

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Rafael was named Leading Individual in Tax by Chambers Global 2003 and 2004-2005 and Highly Recommended Individual for Tax in the 2005 edition of Global Counsel 3000.

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Rafael was named Leading Individual in Tax by Chambers Global 2003 and 2004-2005 as well as Highly Recommended Individual in the 2003-2004 and 2005 editions of Global Counsel 3000. His name also appears in the Legal Media Group's 2003 Guide to the World's Leading Tax Advisers.

URÍA MENÉNDEZ

Faithful to the tradition begun by Professor Uría, the Firm continues to combine the day-to-day practice of law with its academic study and is taking part in the new challenges posed by legal practice and the evolution of the Spanish and Portuguese legal systems. A significant number of our practitioners actively participate in academic and university life, are the authors of numerous legal publications and contribute to the evolution and dissemination of the Law.

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The Tax Department of Uría Menéndez is currently made up of seven partners and five senior associates, assisted by thirty other tax lawyers from the offices of Madrid, Barcelona, Bilbao, Valencia, Lisbon, Porto and New York. The Department advises on all Spanish and Portuguese direct and indirect taxes, but has particular expertise in the following areas:

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- Project finance.
- Internet and electronic business.
- Stock options plans and alternate schemes.
- Financial products and capital markets.
- Real Estate transactions.
- Assurance and pension funds.
- High net worth individuals.

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