RSM Alert

SPANISH NATIONAL COURT DISALLOWS THE DEDUCTION OF INTRA-GROUP SERVICES DUE TO LACK OF EVIDENCE AND AGREMMENT

On 25 January 2022, the resolution of the National High Court (AN) no. 151/2022 (the Resolution) was released which, among other issues, addresses the deductibility for tax purposes of charges for intra-group services.

The Resolution resolves appeal no. 424/2019 against a resolution of the Spanish Central Economic-Administrative Court (TEAC) issued on 4, December 4, 2018. The resolution of the TEAC was initiated upon an inspection of the Spanish tax authorities in relation to Corporate Income Tax (CIT) started in 2012, in respect of 2008 and 2009 fiscal years of a Spanish entity belonging to a multinational group engaged in the management of shopping centres. The Spanish entity received intra-group services from a related party tax resident in Portugal, consisting of strategic business management and marketing services regarding market research. The Spanish tax authorities disallowed the deductibility for tax purposes of services charged based on the lack of evidence provided by the taxpayer, a criterion that was confirmed by the TEAC.

The AN partially confirms the TEAC's position in respect of the non-tax deductibility regarding expenses for strategic business management services but accepting the deductibility of charges for marketing services.

In relation to strategic business management services, the Group centralized in the Portuguese entity certain senior and executive employees with experience and knowledge of the policies defined by the Group in relation to the management of shopping centres, while the rest of subsidiaries, including the Spanish one, were mainly operated by a broad base of employees but with few senior and executive personnel. The Portuguese entity invoiced to the different subsidiaries for the services provided by senior and executive personnel. These invoices included a very generic description "Provision Serv. Pursuant to Contract January 2008", although the contract was not provided.

The Spanish entity intended to prove the existence and benefit of the services through the invoices received , and a reference in the Annual Accounts of the auditor confirming that although no contracts were signed yet, the amounts and items reflected would not differ from those stated in the final agreements. Additionally, the company provided correspondence with the Portuguese entity´s personnel in different areas; explanation and details of the services provided; details of charges and billing; justification of the rationality of cost sharing; lists of travel expenses and supporting invoices issued by the Portuguese entity concerning the provision of strategic business management services of shopping centres located in Spain; contractual management, marketing, *"marketing intelligence"* and *"key account"* in favour of the Spanish company.

The arguments of the TEAC confirmed by the AN to deny the deductibility for tax purposes of the charges for these services are the following:

- The invoice is not a sufficient document to substantiate the reality of the expense, especially when the administration questions its reality. Therefore, the burden of proof is entirely on the taxpayer.
- Although the literal former wording of art. 16.5 of the Spanish CIT Law that required for the tax deductibility of charges for intra-group services the existence of *"a written contract, previously executed, through which the allocation criteria of the expenses incurred for this purpose by the entity that provides them are established"*, is not applicable to the regularized years, it constitutes a relevant information that cannot be ruled out in substantiating the evidence of the tax assessment, especially given the indeterminacy of the services provided and the vague description of such services in the invoices.

- The activities described do not correspond to functions necessary for the business, but rather to coordination, direction, delimitation of economic strategies functions, by the entity of the group, which it is entitled to perform these functions. These functions cannot be regarded as if they could be exercised by a third party. Moreover, even within the Group, such functions can only be exercised by the entity empowered to their use. The activities described are useful not only for the recipient, but for the group as a whole and therefore constitute activities of direction and control.

As regards marketing services, the expenses incurred relates to an analysis of the most relevant tenants of the shopping centres operated in Spain, Portugal and Brazilin order to detect inefficiencies and areas of improvement and implement an action plan to provide support to the centres located in such countries with the aim to improve the services rendered. This study was outsourced to an external provider and the cost allocated among these three countries.

In this case, the AN took into account the taxpayer's allegations and contemplated the reality of the service, its relationship with the activity of the Spanish entity and the benefit or advantage that it provided or may have been provided to the recipient. Consequently, the charges were considered provided and deductible for CIT purposes.

It should be highlighted, the argument used by the AN to deny the TEAC´s criterion which considered that such charges as shareholder costs which benefited the whole Group instead of to the Spanish entity was rejected. The AN understood that in order to determine the characterization of the charges as shareholder costs required a far more exhaustive and comprehensive motivation that the one given by the Spanish tax auditors in line with the OECD Guidelines which consider the restrictive nature of these costs.

In short, the AN resolution is an important precedent in which it requires for tax the deductibility of intra-group charges the existence of an Agreement . This, disregarding the general doctrine and the recommendations included in the OECD Transfer Pricing Guidelines, which in several passages admits the deductibility of intra-group services without the need of a written agreement t. In this sense, it is necessary to remember the Explanatory Memorandum of the Spanish CIT Law itself, which establishes that the OECD Guidelines must be considered an interpretative rule on transfer pricing matters.

As per the above, it should be examined whether the provision of an Agreement would have been sufficient in this case to prove the existence and benefit of the services and, therefore, the deductibility of the charges for tax purposes. This issue is unclear in light of the evidence provided by the taxpayer. At this point, the resolution of the AN creates legal uncertainty as regards the scope of the evidence that taxpayers must provide to substantiate the reality and the advantage or value of the services.

In any case, this Resolution once again highlights the importance of documenting related-party transactions in detail to avoid the non-deductibility of intra-group charges and even the imposition of penalties, as it happened in this case.

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