

CANARY ISLANDS SPECIAL ZONE (ZEC): BEST TAXATION IN EUROPE?

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1. Introduction

The *Zona Especial Canaria* or its acronym ‘ZEC’ is the name given by the Spanish Act 19/1994, of 6th July to the low taxation area of the Canary Islands². Usually, it is also used to name the companies established in that area (known as *ZECs*). Article 29 of Act 19/1994 provides that the Canary Islands Special Zone will remain in force until 31st December 2019 (companies may register up to 31st December 2013), and may be extended beyond that date on the authorisation of the European Commission. This regime was introduced by the Spanish Government in 1994, as part of the Economic and Fiscal Regime of the Canary Islands (REF), by the Act mentioned, without taking into account the provisions of EU Law. This Act was challenged by the European Commission, on grounds of incompatibility with EU law. The Decision of the European Commission of 16th December 1997, confirmed that the fiscal incentives set out in the REF were “forms of help which can be considered to be compatible with the common market in accordance with the Treaty of the European Union and the EEC Agreement”.

The Royal Decree Act 13/1996 of 26th January, Act 13/1996 of 30th December, Royal Decree Act 7/1998 of 19th June and Royal Decree Act 2/2000 of 6th July (Approval of the Canary Islands Special Zone), Royal Decree Act 12/2006, of 29th December, by means of which Act 19/1994, of 6th July, in Modification of

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2 The Canary Islands are one of the seventeen Spanish autonomous communities into which Spain is divided and as such they form part of the European Union (EU) and of the Euro Zone. Administratively, they are divided into two provinces: Las Palmas, made up of the islands of Gran Canaria, Fuerteventura and Lanzarote; and Santa Cruz de Tenerife made up of Tenerife, La Gomera, La Palma and El Hierro. The cities of Las Palmas de Gran Canaria and Santa Cruz de Tenerife share the status of capital.

the Economic and Fiscal Regime of the Canary Islands is modified, and Royal Decree Act 2/2000, of 23rd June, introduced all the appropriate modifications which adapt the fiscal incentives of the Fiscal Regime of the Canary Islands to the provisions set down in the Decision, achieving the full adaptation to the EU regulations.

Finally, the regime was introduced in 2000 (Tax Aid approved by the European Commission on January 18, 2000) for the purpose of promoting the economic and social development of the Islands and the diversification of their production structure. Basically, the intention of the Government with the creation of this regime was to find other kind of businesses apart from tourism. Nowadays, it has been found to be an excellent platform for investments into Africa, because of the sea connections with Africa and the DTCs signed between Spain and some African countries³.

Although ZECs are sometimes considered to be a different kind of company. We must take into account that, as we have seen, the ZEC is only a regime that any newly created Spanish company may accede if meets certain requirements. Moreover, this regime is inside the legal framework composed by EU Law (Parent/Subsidiary Directive), the DTCs signed by Spain and the internal legislation.

2. Requirements of the ZECs

The requirements, which a company has to satisfy, in order to be registered in the Official Register of Canary Island Special Zone Entities and become a ZEC, are set out in Article 31 of Act 19/1994⁴, as follows:

- It must be a newly created corporate entity.
- Its corporate purpose must consist of the undertaking of economic activities (within the geographical area of the Canary Islands Special Zone) included in the annex of Royal Decree Act 2/2000, as amended by Royal Decree Act 12/2006.

3 At the present time, the sea connections of the Canary Islands with Africa include 19 destinations (Angola, Benin, Cape Verde, Cameroon, Congo, Côte d'Ivoire, Gabon, Gambia, Ghana, Guinea Bissau, Guinea Conakry, Liberia, Mauritania, Morocco, Nigeria, Senegal, Sierra Leona, South Africa and Togo) and Spain has signed 8 DTCs with African countries (Algeria, Egypt, Morocco, Namibia, Nigeria, Senegal, South Africa and Tunisia).

4 Article 31 of Act 19/1994 contains the requirements that a company has to meet in order to be registered in the Canary Islands Special Zone. Royal Decree Act 12/2006, of 29th December, amended this article.

- The company must have its head office and effective place of management within the geographical area of the Canary Islands Special Zone.
- At least one of the administrators must reside in the Canary Islands.
- The company must make investments of 100,000.00 euro or 50,000.00 euro, depending on the size of the island, in the first two years following authorisation in the form of the acquisition of tangible or intangible fixed assets, as appropriate, located or received within the geographical scope of the Canary Islands Special Zone and used within this same geographical area during the entire period the entity forms part of the regime or during its useful lifetime, whichever may be shorter, without being transferred.
- It must create a minimum number of jobs within the geographical scope of the Canary Islands Special Zone in the six months following authorisation and maintain an annual average staff headcount of at least this number.
- The company must present a report describing the economic activities to be carried out, accrediting their solvency, viability, international competitiveness and contribution to the economic and social development of the Canary Islands.

ZEC Geographical Area

Although as we have seen before, the ZEC covers all the territory of the Canary Islands, there are certain peculiarities. Companies whose object is the provision of services, may be established anywhere in the territory. On the contrary, when it is a matter of companies whose object is the production, transformation, manipulation and/or marketing of goods, their area of establishment is restricted to the limited areas designated to this purpose⁵.

Newly created company

There has been some controversy about the way to meet the proper requirements imposed on the companies. The main doubts were focused in three questions:

- Can ZEC companies operate in any other market, including the domestic, European or international?

⁵ According to article 30 of Act 19/1994, the distribution of the limited areas in the Islands and their maximum area shall be as follows:

- a) On the islands of Gran Canaria and Tenerife, a maximum of five delimited areas whose total area may not exceed 150 hectares on each of the islands.
- b) On the island of La Palma, two delimited areas whose total area may not exceed 50 hectares.
- c) On the islands of Fuerteventura, La Gomera, El Hierro and Lanzarote, one delimited area per island, whose area may not exceed 25 hectares.

- Was it necessary for the company to register in the Official Register of Canary Islands Special Zone Entities?
- Is it possible for the Permanent Establishments and Branches to become a ZEC? And individuals?

The Parliament of the Canary Islands proposed that the Act 19/1994 should include the following provision: “The Canary Islands Special Zone Entities can operate in any market, including the Canary Islands, the European and the international market with no restriction.” Although this provision was not finally included, the fact that there is no restriction in the Act means that a ZEC company can operate anywhere.

Articles 31.1 and 31.2 of Act 19/1994 clearly state that, to operate as a ZEC company, the company must be a Canary Islands Special Zone Entity and these ones will only be the newly created corporate entities which, having satisfied the requirements mentioned above, are registered in the Official Register of Canary Islands Special Zone Entities. The ZEC companies, to operate as so, must register not only in the Official Register of Canary Island Special Zone Entities, but also in the Mercantile Register, which clearly means a huge inconvenient to attract investors and a discrimination if compared with the companies based in mainland Spain. We believe, like other authors such as GARCÍA MELIÁN⁶ do, that it would have been quite interesting that the registration in the ZEC Register would have been enough, as it could share that information with the Mercantile one.

The Act 13/1996, that amended the Act 19/1994, authorized the registration of both -permanent establishments and braches- and also other entities that were not subject to Corporate Income Tax. Unfortunately, since the promulgation of Royal Decree Act 2/2000, it is only possible to become a ZEC company if it is a newly created Spanish company. However, it is possible for ZEC companies to set up permanent establishments anywhere⁷, with only a requirement of reporting it to the Consortium within one month since the setting up.

Despite of some authors, such as NUÑEZ PÉREZ⁸, arguing that individual business man/woman could become ZECs, this is prohibited by Act 19/1994 which clearly states that only corporate entities can become ZECs.

6 GARCÍA MELIÁN, J. C.: “Las zonas off-shore de Canarias y Madeira”, Noticias de la Unión Europea, issue 154, November, 1997, page 47.

7 If this permanent establishment is located within mainland Spain or outside the ZEC area, the benefits of ZEC companies will not apply.

8 NUÑEZ PÉREZ, G. G.: “Algunas cuestiones jurídico-tributarias en relación con la Zona Especial Canaria (ZEC)”, Serie de Estudios Regionales. Canarias, Servicios de Estudios del Banco Bilbao Vizcaya, Madrid, 1997, page 468.

The Consortium of the Canary Islands Special Zone

This Consortium is a public body, with its own legal personality and assets and full public and private legal capacity, created by the Act 19/1994, with the function of watching over and supervising the activities carried out by Canary Islands Special Zone Entities (both functions to be undertaken by civil servants of the appropriate authority attached to the Consortium). In addition, the Consortium of the Canary Islands Special Zone shall promote and provide the services required for the proper functioning of the Zone and the attaining of its purposes, advise the Spanish Government, the Minister of Finance and the Canary Islands Government on matters related to the Canary Islands Special Zone as requested or on its own initiative and may put forward such proposals on measures or provisions in relation to the Zone as it deems necessary, and, finally, the Consortium shall, on an annual basis, prepare and publicise a report on its activities and the situation of the Canary Islands Special Zone, without prejudice to the preparation and publication of statistics concerning the Zone, with the frequency it deems appropriate⁹.

Head office and effective place of management

Several changes have taken place since the Act 19/1994 came into force. Firstly, the company had to have its head office, its effective place of management and its principal establishment within the ZEC area. After the amendments made by Act 13/1996, it had to have its head office, its effective place of management and a permanent establishment or a branch within the ZEC area. Finally, with the amendments made by Royal Decree Act 2/2000, the ZEC company –apart from having to have its head office and its effective place of management in the ZEC Area- is required to develop its activity within the ZEC area as its principal establishment and not just with a permanent establishment.

Corporate purpose

Although at the beginning, the activities that ZEC companies could conduct included financial services, now they are excluded. The only activities permitted now –which include services and production, processing, handling or marketing of goods- are the ones specified in the annex of Royal Decree Act 2/2000, as amended by Royal Decree Act 12/2006.

Investments

This requirement has been found quite logical due to if a company must make

⁹ Article 37 of Act 19/1994 contains the functions of the Consortium of the Canary Islands Special Zone.

investments in the first two years following authorisation in the form of the acquisition of tangible or intangible fixed assets, this will surely mean that its intention is going to be to make profits from them though its activity. And, moreover, with this requirement the ZEC regime will not find the opposition of the Commission and will comply with EU Law in terms of avoiding the creation of tax havens. However, some authors such as PASCUAL GONZÁLEZ¹⁰, find that a company that invests the amount of €100,000.00 in two years will difficulty promote the economic and social development of the islands and the diversification of their production structure.

Minimum number of jobs

Minimum investment, minimum creation of jobs and the rest of requirements must represent the existence of a real economic activity and not just an entity created to avoid taxes.

According to Article 31.3.e) of Act 19/1994, the companies established in the islands of El Hierro, Fuerteventura, La Gomera, Lanzarote and La Palma will have to create three jobs within six months since their registration in the ZEC Register. In the islands of Gran Canaria and Tenerife: five jobs. When the same activity has previously been carried out under different ownership, minimum net job creation required will be as follows: In the islands of Gran Canaria and Tenerife: five jobs. In the islands of El Hierro, Fuerteventura, La Gomera, Lanzarote and La Palma: three jobs.

This requirement is so important for two reasons: the first one, because meeting it, a company would be –exceptionally– registered in the ZEC Register without meeting the requirement of minimum investment (Article 31.3.d of Act 19/1994); and the second one, because the more jobs created the higher tax base will be taxed to low rate.

3. Taxation

Corporate tax

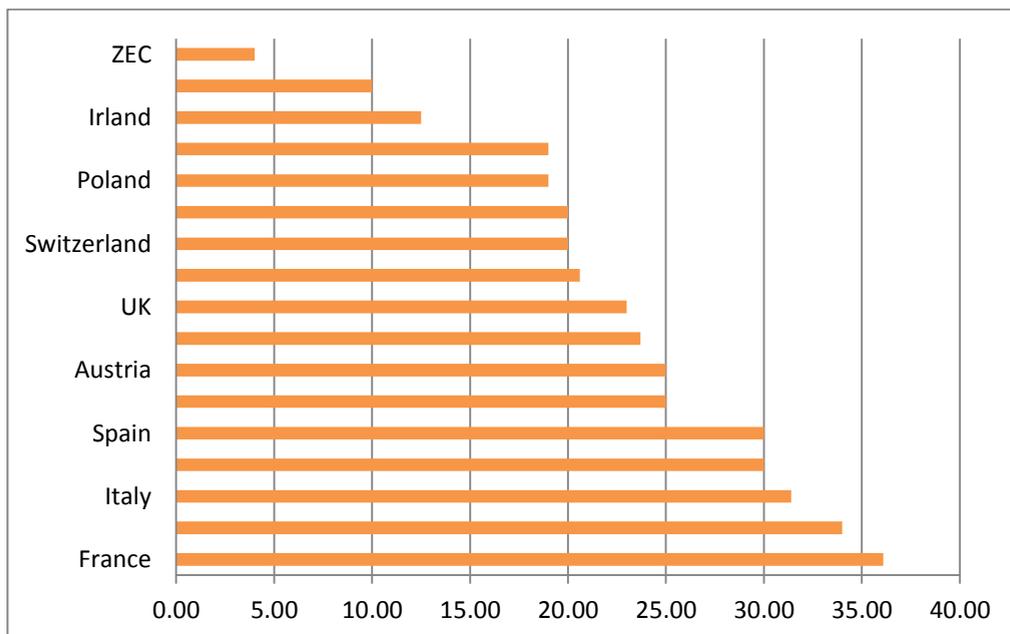
ZEC entities are subject to Corporate Tax in force in Spain but at a reduced rate of 4% applicable (compared to 23% which is the European average), with a maximum base of €120,000,000.00, if the company creates more than 100 jobs.

¹⁰ PASCUAL GONZÁLEZ, MARCOS M.: La reserva para inversiones en Canarias y la zona especial canaria: su configuración como ayudas de estado fiscales, Doctoral thesis directed by Dr. Nunez Perez, Department of Financial Law, Labour and Social Security, University of La Laguna, La Laguna, page 355.

See below the relationship between jobs created and the maximum tax base, depending on the sector.

Net job creation	Industrial activities	Service activities	Other services
Between 3 and 8 employees	€1.800.000	€1.500.000	€1.125.000
Between 9 and 12 employees	€2.400.000	€2.000.000	€1.500.000
Between 13 and 20 employees	€3.600.000	€3.000.000	€2.250.000
Between 21 and 50 employees	€9.200.000	€8.000.000	€6.000.000
Between 51 and 100 employees	€21.600.000	€18.000.000	€13.500.000
More than 100 employees	€120.000.000	€100.000.000	€75.000.000

CIT compared with other European territories



Dividends

The companies are exempt from withholding of dividends from ZEC subsidiaries to their parent companies in other country in the European Union thanks to the

Parent Subsidiary directive and to other countries with which Spain has signed an agreement so as to avoid double taxation (almost one hundred countries). Unfortunately, ZECs with their parent company in mainland Spain are subject to double taxation.

IGIC

ZECs are exempt from the Canarian Indirect General Tax (IGIC, equivalent to VAT) for the provision of goods and services between ZEC entities, and on imports.

Capital transfer Tax and Stamp Duty

ZECs are also exempt from Capital transfer Tax and Stamp Duty in the acquisition of goods and rights for the activity development, in corporate operations (except dissolution) and in documented legal acts related their transactions.

4. Assessment of the ZEC regime

The ZEC tax regime is fully compatible with EU Law based on the consideration of the special characteristics and constraints of the outermost regions established in the article 349 TFUE (ex Article 299(2), second, third and fourth subparagraphs, TEC).

Despite the structural social and economic situation of the Canary Islands, derived primarily from their remoteness¹¹, it must be taken into account by those entrepreneurs considering investments in Africa as an excellent platform from where managing them. The Spanish ZEC is a resident company for the purpose of Double Tax Treaties signed by Spain, which basically means that it can benefit from the provisions of such norms (some limitations may apply if the Double Tax Treaty contains a limitation on benefits provision, which, although not usual in Spanish Double Tax Treaties, may be found in some of them: e.g. Portugal, Ireland, US).

The Canary Islands have, as we have seen before, sea connections with Africa that include destinations such as Angola, Cameroon, Congo, Côte d'Ivoire, Gabon, Gambia, Ghana, Guinea Bissau, Guinea Conakry, Liberia, Mauritania, Morocco, Nigeria, Senegal, Sierra Leona, South Africa and Togo and an increasingly important Double Tax Treaty network featuring almost one hundred Double Tax

¹¹ The Canary Islands are located in from of the Northwest of Africa, 100 km from their coast and 1,000 km from mainland Spain.

Conventions with almost all European countries and some of them with African countries such as Algeria, Egypt, Morocco, Namibia, Nigeria, Senegal, South Africa and Tunisia. The Spanish Treaty Network is expanding rapidly and is expected to grow in the coming years. Additionally, the ZECs may take advantage of the Parent-Subsidiary Directive: 0 % withholding tax for dividends received from subsidiaries resident in other European Union countries (if the conditions for the application of such a norm are complied with). Moreover, the ZECs are exempt from the Canarian Indirect General Tax for the provision of goods and services between ZEC entities, and on imports, Capital transfer Tax and Stamp Duty in the acquisition of goods and rights for the activity development, in corporate operations (except dissolution) and in documented legal acts related their transactions.

5. Conclusions

Although it took some time for this regime to meet the provisions of the EU Law (more than six years), the ZEC regime has become quite useful to promote the economic and social development and the diversification of the production structure of the Canary Islands. We can affirm that the intention of the Government of Spain to find other kind of businesses apart from tourism has become a success. This affirmation is supported by some figures such as jobs created (6,419), investment (€627,179.502) and rate of survival (74%).

Basically, the regime has been found very attractive for two kind of businesses: *the first one*, multinational groups that have a subsidiary in the ZEC area as a platform to enter in Africa (e.g. mine site and brownfield exploration, renewable energy sources) and, *the second one*, businesses that create lots of jobs and can operate anywhere (e. g.: call centres, customer relationship management, brewery).

We find this regime quite attractive, especially for the businesses mentioned above and, although it is only authorised to remain in force until 31st December 2019 (companies may register up to 31st December 2013), the prevision is that the authorisation of the European Commission will be extended beyond that date.