

**DRAFT**

Madrid, 11 January 2005

**CNP ASSURANCES, S.A., Sucursal en España**  
Paseo de la Castellana, 60  
28046 Madrid

For the attention of Mr. Pablo González de Castejón

Dear Pablo,

As per your request, please find below our comments regarding the Spanish tax implications that could arise, from a direct and indirect point of view, from the fact that the Life CNP Assurances Spanish Branch (hereinafter the Life Branch) has assumed all the expenses related to the incorporation of CNP Assurances in Spain.

**I. BACKGROUND**

According to the information provided during the meeting held in your office CNP ASSURANCES group has incorporated during 2004 two branches in Spain in order to carry out its non-life and life insurance activities (the Non-Life Branch and the Life Branch respectively) in our territory.

All the expenses related to the incorporation of both branches (Notary, Registry, and other operational expenses such as rent, etc..) have been paid and registered by the Life Branch. Up to now, neither of the branches had started its activity in Spain and consequently, none of them have registered income in their account books for 2004 fiscal year.

According to your information, the Life Branch will not recharge the expenses to the Non-Life Branch.

**II. TAX IMPLICATIONS**

- Corporate Income Tax

The main consequence of the Life Branch assuming expenses correspondent to the Non-Life Branch would be that the Spanish Tax Authorities might consider that the Life Branch is rendering a service to the Non- Life Branch free of charge

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Since the Non-Life Branch and Life Branch are related parties in the sense of the Spanish Corporate Income Tax Act (hereinafter CIT Act) it should be applicable the provisions contained in Article 16 of the mentioned Act that establishes the following:

*“The Tax Authorities may value, before the statute of limitations expires, operations performed between related persons or entities at their normal market value when, considering the related persons or entities overall, the agreed valuation would have lead either to lower taxation in Spain than that which would have existed on applying the normal market value, or to a deferral of such taxation.”*

In other words, operations performed between related parties by a price lower than the normal market value may only be readjusted by the Spanish Tax Authorities if considering the operation overall, a lower taxation or a deferral of such taxation comes out.

Taking into account that in FY2004, both branches will obtain tax losses, the fact that Life Branch has assumed the expenses regarding the incorporation of Non- Life Branch, will not give rise, in principle, to lower taxation in Spain during the mentioned fiscal year.

Nevertheless, taking into account that tax losses may be offset against the positive income of the tax periods that end in the successive fifteen years as from the first tax period in which positive taxable income is obtained, this situation could not be verified until such circumstance has taken place.

Under such scenario, the Spanish Tax Authorities would adjust the Non-Life and the Life Branches taxable income to the amount resulting of applying a market basis, i.e., recharging the expenses incurred from Life Branch to Non-Life Branch.

- Value Added Tax

The fact that both Spanish branches do not directly hang from the same Head Office implies that they are different legal entities from a Spanish Value Added Tax (hereinafter VAT) point of view. In this respect, services rendered between them may be subject to VAT according to Spanish VAT rules.

In accordance with Articles 1 and 4 of the Spanish VAT Act, the supply of services between different companies will be subject to Spanish VAT. More precisely, Article 11. 15º establishes that the *“intermediation transactions, and agency or commission transactions when the agent or commission agent acts in the name of another”* shall be deemed to be supplies of services subject to Spanish VAT and specifies that “When he acts in his own name and mediates in a supply of services, he shall be deemed to have received and supplied the services in question himself”

Taking into account the above we can conclude that a hypothetical inspection may consider that the Life Branch is rendering to the Non-Life Branch certain type of services (consistent on the incorporation of a branch: Notary, Registry, etc) which are subject and not exempt from Spanish VAT.

Although the services are rendered free of charge it is important to bear in mind that, according to Articles 12 and 79 of the Spanish VAT Act, supplies of services made between

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related parties free of charge shall be considered “self-supplies” of services subject to VAT, being the taxable amount the cost of supplying the services.

In conclusion, we consider that, unlike in Corporate Income Tax, from a Spanish VAT point of view, there is a potential risk that a hypothetical tax inspection considered that the Life Branch should charge VAT. However, this theoretical and potential risk should be compared with the real cost which would arise in the event that the Life Branch charges directly VAT (by the corresponding regularization process), being a cost for the Non-Life Branch receiving the service.

The Life Branch may regularize (before the Spanish Tax Authorities begin a tax inspection) the situation by charging VAT (16% on the amounts recharged) to the Non-Life Branch and filing complementary VAT returns. The cost of such regularization would be the VAT tax quota that, as established before, would be a final cost for the Non-Life Branch receiving the service and a delay surcharge, which the Spanish Tax Authorities might impose to the Life Branch.

This surcharge would be of 5%, 10% or 15% on the tax quota (without delay interests) depending on if the delay of the payment exceeds of three, six or twelve months. In this sense, the regularization of the VAT would imply the following surcharges, provided that such regularization takes place before next January 20, 2005:

- regularization of the VAT corresponding to expenses paid during the month of June: a surcharge of 10%.
- regularization of the VAT that corresponds to amounts paid between the first July until September 30: a surcharge of 5%
- Finally, the regularization of the VAT corresponding to expenses paid during the last quarter of the year 2004 will not imply any surcharge.

On the contrary, if the Spanish Tax Authorities did such regularization in the course of a tax inspection, the cost of it could amount to the VAT tax quota (16% on the amounts recharged) plus a penalty (approximately of 50% over the tax quota) plus the corresponding delay interests (calculated over the tax quota). Please note that in certain cases it is possible to negotiate with the Spanish Tax Authorities the final amount of the penalties to be imposed.

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We hope that these comments prove useful to you. In any event, should you have any question or require any clarification, please do not hesitate to contact us.

Best regards,

Joaquín Latorre