03
2018-2019

Cuadernos de Gibraltar
Gibraltar Reports

Revista Académica sobre la Controversia de Gibraltar
Academic Journal about the Gibraltar Dispute

http://doi.org/10.25267/Cuad_Gibraltar

CUADERNOS DE GIBRALTAR – GIBRALTAR REPORTS
Num 3, 2018-2019 | ISSN 2444-7382
DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309

Citation: CHECA RODRÍGUEZ, A., «The Bilateral Tax Treaty between the United Kingdom and Spain Regarding Gibraltar: another Step in Gibraltar's Quest for De-listing as a Tax Haven», *Cuadernos de Gibraltar–Gibraltar Reports*, num. 3, 2018-2019.

Received: 2 March 2020.
Accepted: 17 April 2020.

THE BILATERAL TAX TREATY BETWEEN THE UNITED KINGDOM AND SPAIN REGARDING GIBRALTAR: ANOTHER STEP IN GIBRALTAR'S QUEST FOR DE-LISTING AS A TAX HAVEN

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ABSTRACT: This article tries to address the different issues raised by the Tax Agreement between the United Kingdom and Spain regarding Gibraltar. In this sense, we aim at providing the reader with an insight on the Spanish tax consequences that the Agreement may bring to individuals and entities tax resident in Gibraltar.

KEYWORDS: Tax Agreements, Tax residency, Double Taxation, Administrative cooperation in tax matters, Gibraltar, Spain.

EL ACUERDO INTERNACIONAL EN MATERIA DE FISCALIDAD ENTRE EL REINO UNIDO Y ESPAÑA SOBRE GIBRALTAR: UN PASO MÁS EN EL OBJETIVO DE GIBRALTAR DE SALIR DE LAS LISTAS DE PARAÍSOS FISCALES

RESUMEN: Este artículo trata de analizar las diferentes cuestiones que suscita el Acuerdo en materia de fiscalidad entre el Reino Unido y España en relación con Gibraltar. En este sentido, se pretende proporcionar al lector un análisis de las implicaciones fiscales que el Acuerdo puede tener sobre individuos y entidades residentes fiscales en Gibraltar.

PALABRAS CLAVE: Acuerdos en materia de fiscalidad, residencia fiscal, doble imposición, cooperación administrativa en materia fiscal, Gibraltar, España.

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I. INTRODUCTION

The Spanish tax treatment for those who have interests in both Spain and Gibraltar and live a cross-border life has always been complex due to the absence of a double tax agreement applicable to Gibraltar and the consideration of the territory of Gibraltar as a tax haven for Spanish tax purposes. The ratification of the International Agreement on Taxation entered into between Spain and the United Kingdom regarding Gibraltar ("the Agreement") may put an end to this situation and provide a higher degree of certainty regarding tax residency and the tax treatment of cross-border transactions.[2]

The Agreement is the outcome of a political compromise reached in the negotiations between Spain and the United Kingdom in the context of Brexit. As such, it is part of a package of agreements resulting from Brexit and is referred to in the Protocol on Gibraltar within the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community.[3]

The fact that the Agreement includes an enhanced administrative cooperation in tax matters should result, if the cooperation and exchange of information proves to be effective, with the eventual de-listing of Gibraltar as a tax haven for Spanish tax purposes.[4] However, it is likely to be some time before Gibraltar is de-listed.

[2] The Agreement has been published in the Official Gazette of the Spanish Parliament (*Boletín Oficial de las Cortes Generales*) on 14 February 2020, initiating the process of parliamentary approval. On the other hand, the Agreement is also in the process of being approved by the British parliament –an Act from Gibraltar parliament will also be required in order to implement the Agreement–. Thus, it can be expected that the Agreement will be in force within year 2020. The official texts in English and Spanish can be found in the following links: <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/786284/CS_Spain_1.2019_Tax_Gib.pdf>; <http://www.congreso.es/public_oficiales/L14/CORT/BOCG/A/BOCG-14-CG-A-7.PDF>.

[3] *OJ,* L 29, 31.01.2020.

[4] It is to be noted that Gibraltar is not included in the EU list of tax havens since 2009 and that since 5 July 2019 it joined the inclusive framework on BEPS (*vid.* Falcón y Tella, R., "El Nuevo Acuerdo Fiscal con Gibraltar, pendiente de ratificación", *Revista Quincena Fiscal*, November, 2019, pp. 1-3). For the status of Gibraltar as a tax haven according to the Spanish official position *vid.* Santa-Bárbara Rupérez, J. "Un ejemplo de paraíso fiscal: el peñón de Gibraltar", *Anuario jurídico y económico escurialense*, Nº 35, 2002, pp. 251-268; Díaz Abad, N., "La Fiscalidad de Gibraltar a examen", *Revista Española de Derecho Europeo*, Nº 41, 2012, pp. 7-13.

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ISSN 2444-7382
DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309

With such de-listing, we can anticipate that individuals tax resident in Gibraltar will have a clearer set of rules and a friendlier Spanish tax environment since Spanish anti-tax haven legislation would no longer be applicable. In particular, the de-listing will have a positive impact on cross-border workers, who will then be able to benefit from an exemption on employment income obtained in Gibraltar up to 60,100€ per year. Such exemption is not applicable today because Gibraltar is classified as a tax haven for Spanish tax purposes.

This conclusion may not be so straightforward for Gibraltar companies when a certain degree of management and control is exercised in Spain. The Agreement will have an impact mainly on Gibraltar companies which: (i) own directly or indirectly Spanish real estate assets; or (ii) whose shareholders or directors are individuals tax resident in Spain.

The use of Gibraltar companies to hold Spanish real estate directly was very extensive in the past as a form of what today would probably be considered aggressive tax planning. As a result, the Spanish tax administration introduced some time ago anti-tax haven legislation to deter this practice. This resulted in further complexity with the incorporation of Spanish companies or foreign companies within the ownership structure between the Gibraltar Company and the property.

Additionally, the introduction and implementation of the requirement to value related party transactions at arm's length, has resulted in these structures carrying annual tax costs higher than those which would arise under direct ownership. Besides, two-tier structures have resulted in many cases in double taxation upon exit.

The entry into force of the Agreement will result in these pure holding companies incorporated and managed in Gibraltar, or subject to its legislation, being considered as tax residents in Spain, which eventually may force taxpayers to simplify these structures.

On the other hand, Gibraltar entities whose shareholders or directors are individuals tax resident in Spain may be deemed, under the Agreement, tax resident entities in Spain, unless they fall within the exclusionary clause. Whether being a tax resident entity will result in a higher or lower tax rate, will depend on the circumstances of the company and on whether Gibraltar is de-listed or not as a tax haven for Spanish tax purposes.

ISSN 2444-7382
DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309

The inclusion of legal structures or arrangements as potential taxpayers of Spain is unprecedented and its effects can hardly be predicted. Clarification will be required from the Spanish administration on how this will have an impact not only on regular family trusts but also on other arrangements such as pension trusts or real estate investment trusts.

In this paper, we will address the different issues that this Agreement tries to deal with and we will aim at providing the reader with an insight on the Spanish tax consequences it may bring to individuals and companies tax resident in Gibraltar.

II. TAX RESIDENCY RULES FOR INDIVIDUALS

The Agreement, as any Double Tax Agreement, provides for a tie-breaker rule for the tax residency of individuals. This tie-breaker rule only comes into play when, according to the tax laws of each jurisdiction, the individual is considered tax resident in both jurisdictions and therefore a tax residency conflict takes place.

However, differently from a standard Double Tax Agreement, the tie-breaker rule under the Agreement is not intended only to have the effect of distributing taxing rights between the two jurisdictions –since there are no rules for the distribution of taxing rights within the Agreement-. Instead, the tie-breaker rule under the Agreement is designed to have an impact on the characterization of the individual as tax resident or non-tax resident under Spanish and Gibraltarian domestic tax rules. Therefore, if under the tie-breaker rules an individual is considered to be tax resident in Spain exclusively, he will thus cease to be considered as tax resident in Gibraltar under Gibraltarian domestic tax laws and vice versa.

Until the de-listing of Gibraltar as a tax haven takes place, Spanish anti-tax haven legislation will continue to be applicable for the purpose of determining tax residency according to Spanish tax law. Thus, individuals tax resident in Gibraltar with a significant presence in Spain may be considered tax residents for Spanish tax purposes unless they can prove physical residence in Gibraltar for more than 183 days within the calendar year – such proof is not an easy task even if planned ahead-. "Significant presence" is not defined and it is actually applied in practice to individuals with a home in Spanish territory that is available for them, no matter the actual degree of use they make out of it.

ISSN 2444-7382
DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309

Of course, the application of the tie-breaker rule under the Agreement requires the individual to be characterized as dual tax resident according to the tax laws of both jurisdictions. As discussed above, an individual tax resident in Gibraltar with significant presence in Spain would need to provide evidence of more than 183 days of permanence in Gibraltar to fall outside Spanish tax residency rules. If he is able to do so, he is no longer a Spanish tax resident under Spanish domestic tax laws. Only if he is not able to provide evidence of such permanence, he would be deemed Spanish tax resident and there comes a conflict of tax residences to be solved according to the tie-breaker rules within the Agreement. Considering that the only test under the tie-breaker rule which would give exclusive tax residency to Gibraltar is to provide evidence of 183 days of permanence in Gibraltar, we can say that the tie-breaker rules in the Agreement do not add significantly to the current state of the law applied in Spain.[5]

However, let us not forget that the other four tests under the tie-breaker rules can only lead towards Spanish exclusive tax residency when: a) the individual spends over 183 overnight stays of the calendar year in Spain; b) in the event that, pursuant to the Spanish tax legislation, their spouse or the natural person with whom a similar relationship has been established, and/or any dependent ascendants or descendants, resides or reside habitually in Spain; c) the only permanent home at their disposal is in Spain; and d) two thirds of their net assets, determined pursuant to Spanish Tax legislation, whether held directly or indirectly, are located in Spain.

The above 4 tests, which would only apply to individuals tax residents in Gibraltar who are not able to provide evidence of more than 183 days of permanence in Gibraltar, would put them in a worse position in two particular cases: (i) where a relative is tax resident in Spain according to Spanish tax

[5] The presumption under art. 2 (1) (b) (ii) of the Agreement does require the taxpayer to additionally provide evidence that he or she has a permanent home for his or her exclusive use in Gibraltar. However, we can anticipate that most individuals tax resident in Gibraltar would meet this requirement. We have extracted the text below: "(ii) When the provisions of paragraph (1)(b)(i) are not conclusive, natural persons shall be considered tax residents only in Spain, unless they are able to provide reliable evidence that they have a permanent home for their exclusive use in Gibraltar and remain in Gibraltar over 183 days"

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DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309

law[6]; or (ii) where the individual has a permanent home at his or her disposal only in Spain. In these two cases one could argue that the individual is probably worse off with the introduction of the Agreement than in the current situation.

After the de-listing of Gibraltar as a tax haven, we can anticipate that it should be easier for tax resident individuals in Gibraltar to fall outside the scope of Spanish domestic tax residency rules, meaning that there will be no dual residency conflict to solve through the Agreement and the individual would be tax resident exclusively in Gibraltar.

Once anti-tax haven legislation is not applicable, tax resident individuals in Gibraltar would only qualify as tax residents in Spain according to Spanish domestic tax law if: (i) they spend more than 183 days in Spain within the calendar year; or (ii) their centre of economic interests is in Spain. Days of sporadic absences out of Spain would not be taken into account for the 183-day rule as long as the individual provided a Gibraltar tax residency certificate. The burden of proof as to the 183-day rule would then be shifted from the taxpayer to the Spanish tax authorities.

Furthermore, the entry into force of the Agreement would facilitate the resolution of tax residency conflicts through a mutual agreement procedure. This procedure may be especially useful in those cases where the discussion is focused on the proof of permanence in Gibraltar.

Individuals who benefit from special tax regimes such as Category 2 tax status, HEPSS or equivalent schemes that may be created in the future, and which do not qualify as tax resident individuals in Gibraltar according to

[6] Please note that the wording in the English version and the Spanish version is not the same. We have interpreted this rule according to the English version in the sense that if any of the following persons are tax resident in Spain according to Spanish tax legislation, then the individual would also be considered tax resident in Spain: (i) spouse not legally separated; (ii) natural person with whom a similar relationship has been established; (iii) dependent ascendants; or (iv) dependent descendants. We have extracted below art. 2 (1) (i) B. to highlight the differences between the Spanish and English versions, referred to above at note no. 2; the emphasis is of course ours: "B. en caso de que, de conformidad con la legislación tributaria española, su cónyuge (del que no estén legalmente separados) o la persona física con la que se haya establecido una relación similar, *así como* los ascendientes o descendientes dependientes, tengan su residencia habitual en España" ("B. In the event that, pursuant to the Spanish tax legislation, their spouse (from whom they are not legally separated) or the natural person with whom a similar relationship has been established, *and/or* any dependent ascendants or descendants, resides or reside habitually in Spain").

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DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309

Gibraltar tax laws, will not be considered tax residents in Gibraltar for the purposes of the Agreement. It is unclear however how they will be treated under Spanish domestic tax residency rules. Most probably, their tax status in Gibraltar will be disregarded by the Spanish tax authorities and days of sporadic absences –including days of permanence in Gibraltar- will be taken into account for the 183-day rule even if Gibraltar is de-listed as a tax haven. In this regard, it is worth mentioning that individuals benefiting from these special tax regimes may also be considered ordinary tax residents in Gibraltar if they meet certain criteria. In such case, they could be considered resident in Gibraltar in the sense of the Agreement, and a formal backing from the Gibraltarian Revenue authority would better be sought to this end (such as a certificate of ordinary residence).

As noted, the de-listing as a tax haven will be a critical step. To the extent that Gibraltar complies with the cooperative measures discussed below, it should expect to be de-listed. A different and more difficult question to answer is the status of Gibraltar during the period in which it was complying with the Agreement but Spain had not yet expressly taken the decision to de-list Gibraltar; or the consequences for an individual whose entire information was properly and duly made available to the Spanish tax authorities before any such decision was actually made and formally announced.

The residency rules contained in the Agreement will come into effect for the taxable periods beginning after the ratification of the Agreement by the two parties. Since the taxable period for individuals is different in each jurisdiction –calendar year in Spain and July 1 to June 30 in Gibraltar- one could argue that it should only apply for the first period were a new taxable period has begun in both jurisdictions. A prudent approach however calls for considering that Spanish tax officials will consider the Agreement to be effective on the first taxable period beginning after the entry into force of this agreement. The earliest Spanish tax period for which this can apply begins on January 1, 2021.

III.- EXTENDED TAX RESIDENCY PERIOD FOR INDIVIDUALS

The Agreement introduces rules on an extended tax residency period for individuals who move from Spain to Gibraltar (a.k.a. "tax quarantine rules" or "sticky period"). According to current Spanish tax legislation, a Spanish

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DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309

national who ceases to be a tax resident in Spain upon his or her move to a jurisdiction classified as a tax haven for Spanish tax purposes –such as Gibraltar for the time being- continues to be considered Spanish tax resident in the year in which the change of residency takes place and continues for the following four taxable years. The scope of the sticky period rule introduced in the Agreement under art. 2. (1) (c) exceeds the scope of the sticky period rule under Spanish law in the sense that: (i) apparently applies to Spanish nationals without temporal limitation (i.e. not only to the year of the move and the following four years); (ii) applies also to non-Spanish nationals; and (iii) does not seem to require that the individual ceases to be tax resident in Spain, meaning that theoretically it would be applicable to a Spanish national who moved to Gibraltar from abroad and never set foot in Spain.

Since the scope of the sticky period rule under the Agreement is clearly beyond the sticky period rule under Spanish anti-tax haven laws, it is unclear whether a change in Spanish tax law may be needed in order to implement the Agreement, although a reasonable approach calls for considering that the Treaty will be effective on this point even without the amendment of Spanish domestic legislation, especially if Gibraltar is eventually going to be de-listed.

The sticky period does not apply to Gibraltarians who spend less than 4 years in Spain and third-country nationals who spend less than one complete tax year. This exclusionary provision should be interpreted as counting days spent after this agreement enters into effects.[7] Otherwise this rule may have an undesired retrospective effect.[8]

It is worth highlighting that the sticky period for Spanish nationals will be applicable to individuals who move to Gibraltar after the date of signature of the Agreement, i.e. March 4, 2019.

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[7] It is worth mentioning here that the reference time-period is not the same for Gibraltarian than for third-country nationals, i.e. "complete tax year" vs "year". For ease of reference, we have extracted art. 2 (1) (c) (2) below: "Non-Spanish nationals who provide proof of their new residency in Gibraltar shall not lose tax residency in Spain. This rule shall apply in the tax period in which the change of residency is made and during the four subsequent tax years. This paragraph shall not apply to non-Spanish nationals that spend less than one *complete tax year* in Spain or registered Gibraltarians that spend less than 4 *years* in Spain".

[8] This interpretation would be consistent with the wording used in the Agreement, which uses the verbal tense "spend" instead of "spent" and the rules in relation to the temporal scope of application under art. 8 of the Agreement.

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IV. TAX RESIDENCY RULES FOR LEGAL PERSONS, ENTITIES AND OTHER LEGAL STRUCTURES OR ARRANGEMENTS

Differently from the tie-breaker rules for individuals, the rules in relation to tax residency of legal persons, entities and other legal structures or arrangements do not state that they should apply once a tax residence conflict arises according to the domestic tax laws of each jurisdiction. Instead, they provide rules for the determination of exclusive tax residency in Spain in relation to legal persons, entities, and other legal structures or arrangements, established and managed in Gibraltar, or governed by its legislation.

Considering that these new rules go beyond the scope of tax residency rules for entities according to Spanish tax law, the same question arises as with the sticky period for individuals: may these rules be applicable without a change in Spanish domestic tax law? As suggested above an affirmative answer is the most likely.

The four tests to determine exclusive Spanish tax residence under the Agreement are the following: a) the majority of the assets, whether directly or indirectly owned, are located in Spain or consist of rights that may or must be exercised in Spain; b) the majority of the income accrued in a calendar year derives from sources in Spain, pursuant to article 13 of the codifying legislation of the Non-resident Income Tax Act of the Spanish tax legislation as may be amended from time to time; c) the majority of the natural persons in charge of effective management are tax resident in Spain; d) the majority of the interests in the capital or equity, voting or profit-sharing rights are under the direct or indirect control of either natural persons who are tax residents in Spain or legal persons, entities and other legal structures or arrangements linked to tax residents in Spain.

Out of the four tests included in Art. 2. (2) (a), the first two tests are currently in place under Spanish tax law–location of majority of assets and source of majority of income- and it is applicable as an anti-abuse rule which may be used by the Spanish tax authorities only on entities tax resident in a black-listed jurisdiction with a savings clause for when there is business rationale for their incorporation. The second test –source of majority of income- should have a limited impact considering that Spanish-sourced gross income would already have been taxed at a flat rate of 24% -or 19% if passive income-. Should the entity be considered tax resident in Spain, it would be

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DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309

taxed at 25% on its net income. Whether being considered tax resident in Spain results in a higher taxation would depend on the comparison between the reduction obtained as a result of the change in tax basis –gross to net- and the taxation on the non-Spanish sourced income. In this regard, the double tax relief method in relation to Gibraltar sourced income will be relevant, as explained below.

The third –residency of natural persons in charge of effective management- and fourth tests– residency of natural persons with interests on the entity-, on the other hand, may have a considerable impact. Its direct application would probably result in all Gibraltar entities or arrangements effectively managed by Spanish tax residents or controlled by Spanish tax residents being deemed Spanish tax resident even if the business is carried out in Gibraltar. One could argue that the underlying consideration is that, given the cross-border nature of the relations between Spain and Gibraltar, and how new technologies have affected the way people conduct business, the principle of place of effective management of the company is no longer the most adequate to determine residence of entities. A company is then considered to be resident where its shareholders and/or directors are tax residents.

The new residency rules would be applied without prejudice to the potential use of the exclusionary clause applicable to companies incorporated before November 16, 2018 and which satisfy the substance tests established under art. 2. (2) (b). It is worth highlighting, in relation to this exclusionary clause, the compromise acquired by the Gibraltarian tax authorities to provide the Spanish tax authorities with a list of legal persons, entities and other legal structures or arrangements which fall within the exclusionary clause by March, 31, 2020 –to date it seems such list has not been provided–.

Finally, there is also a rule under art. 2. (2) (e) in relation to the migration of companies from Spain to Gibraltar which provides that these entities shall in all cases maintain tax residency only in Spain. However, considering that it is unusual for Spanish companies to move their tax residency to Gibraltar, the impact of this rule should be rather limited.

V. ELIMINATION OF DOUBLE TAXATION AND EXCHANGE OF INFORMATION AND ENHANCED ADMINISTRATIVE COOPERATION

According to art. 2 (3) each jurisdiction shall eliminate double taxation pursuant to the provisions of their domestic law. This provision will have a very limited impact considering that: (i) double tax relief is already being granted by Spanish domestic tax laws in relation to Gibraltar taxes; and (ii) double tax relief should not be an issue in Gibraltar considering that this jurisdiction only taxes on a territorial basis.

It is worth mentioning here that after a possible de-listing, the Spanish domestic exemption of profits attributable to a foreign permanent establishment may provide a certain degree of effective relief in these situations.[9] However, Spanish tax may arise for payments to non-residents in Spain made by these companies.

Under the agreement, Gibraltar has committed itself to be aligned with EU law on mutual administrative assistance for tax purposes even after Brexit (end of the transition period: December 31, 2020). In terms of exchange of information, it will have retrospective effect after the date of entry into force of the Agreement for taxable periods commencing on or after January 1, 2014 in relation to: (i) cross-border workers; and (ii) vessels, aircraft and motor vehicles registered in Gibraltar relating to Spanish residents. The rest of the information, will have retrospective effect for periods commencing on or after January 1, 2011.

Furthermore, Gibraltar and Spain have agreed to provide mutual administrative assistance to each other in tax matters, whether the person affected is a resident or a non-resident of either party, including exchange of information –automatic or upon request- assistance with debt collection and the serving or transfer of documents.

VI. CONCLUSIONS

The impact the Agreement will have on the tax residency of individuals will depend on whether Gibraltar is eventually de-listed as a tax haven for

[9] Although Brexit took place on 31 January 2020, this would only be an issue after the end of the transition period (December 31, 2020). This exemption may be applicable today, under the transitional period, whenever the location in Gibraltar is based on valid business reasons.

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DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309

Spanish tax purposes. Should Gibraltar be de-listed, the burden of proof under the 183-day rule for determining residence under Spanish domestic tax laws would be shifted from the taxpayer to the tax administration. Therefore, the de-listing results in a heavier burden of proof upon the Spanish tax administration, which until now has been relying only on the "significant presence" test. As discussed, such test is not defined and it is actually applied in practice to individuals with a home in Spanish territory that is available for them, no matter the actual degree of use.

Another positive outcome of the de-listing would be that Spanish anti-tax haven legislation would no longer be applicable. In this regard, one of the most positive results would possibly be the application of the Spanish domestic exemption for work performed abroad up to 60,100€ per year, something from which cross-border workers would benefit.

The de-listing would also have a positive impact upon other non-tax issues, as for example the possibility of applying simplified measures instead of reinforced measures under EU anti-money laundry regulations, which will be specifically relevant for the finance and banking industries.

The advantages above derived from the eventual de-listing come at a cost for Gibraltar, considering that:

(i) the application of the tie-breaker rules in the Agreement cannot properly be understood without the de-listing;

(ii) the Spanish tax administration has kept for itself significant advantages under the tie-breaker rules, also in a post de-listing scenario;

(iii) the extended scope of tax residency rules for companies; and

(iv) the extended scope of the tax quarantine rules both for individuals and companies.

To sum up, the Tax Agreement between the United Kingdom and Spain regarding Gibraltar and the eventual de-listing of Gibraltar from the Spanish list of tax-havens will bring a friendlier tax environment for cross-border transactions between Spain and Gibraltar and for those individuals who wish to live between these two territories. Of course, the new bilateral tax regime, which is also the result of the first Treaty between the United Kingdom and Spain concerning Gibraltar in three hundred years, comes at a cost in terms of some advantages gained by the Spanish revenue authorities.

ISSN 2444-7382
DOI http://doi.org/10.25267/Cuad_Gibraltar.2019.i3.1309