

Spanish Supreme Court issues favorable decision on reclaims for US RICs

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Executive summary

On 13 November 2019, the Spanish Supreme Court (*Tribunal Supremo*) issued a favorable decision confirming the right of a United States (US) Regulated Investment Company (RIC) to obtain a refund of the Spanish withholding tax on dividends paid in excess.

The US RIC filed a reclaim to obtain a refund of the difference between the dividend withholding tax (DWHT) imposed and the reduced 1% applicable to Spanish Collective Investment Vehicles (CIVs), insofar as it implies discriminatory tax treatment for nonresidents in comparison with Spanish CIVs.

The Spanish Supreme Court has addressed two specific matters: (i) whether a US RIC should be compared to (the features of) a Spanish CIV or to (those of) a European Union (EU) Undertakings for Collective Investments in Transferable Securities (UCITS) fund¹ in order to determine if there is an infringement of EU Law; and (ii) whether the tax information exchange agreement established in the Spain-US tax treaty² is a valid tool to allow the Spanish tax authorities to verify the features of the US RIC to assess comparability.

Detailed discussion

Background

The US RIC in the case at hand (a mutual fund) filed a reclaim to obtain a refund of the difference between the dividend withholding tax imposed in 2009 and the reduced 1% Corporate Income Tax (CIT) rate applicable to Spanish CIVs, insofar as it implies discriminatory tax treatment for nonresidents in comparison with Spanish CIVs, contrary to EU Law.

The Spanish Nonresident Income Tax (NRIT) Law was amended effective 1 January 2011, after which EU UCITS funds benefitted from a 1% DWHT (by way of a refund of excessive taxes) instead of the standard applicable domestic/tax treaty rate. However, this reduced DWHT rate does not apply to funds that are not UCITS and, consequently, to a US RIC.

The Spanish Supreme Court issued a decision earlier this year,³ confirming that the Spanish tax legislation prior to this amendment entails a restriction on the free movement of capital established by EU legislation, insofar as it implies unfavorable tax treatment for nonresident UCITS funds in comparison with Spanish CIVs.

This new decision further recognizes that the same conclusion can be drawn regarding US RICs, if certain conditions are met, as further explained below.

EY Spain has assisted the US RIC in this milestone case throughout the reclaim and litigation procedure.

The Decision

Under the Spanish Supreme Court view, the Spanish NRIT Law does not provide a mechanism for nonresidents to assert their right to the application of the reduced rate while the national legislation provides such for Spanish tax residents. This consideration is based on the fact that, unlike the Spanish CIT Law, the Spanish NRIT Law does not provide for a specific procedure for the refund of the excess DWHT, but rather nonresidents are required to follow the general procedure to claim undue taxes established in the Spanish General Tax Law.⁴ For this, there is no regulatory framework that allows them to achieve equal treatment between Spanish and non-Spanish CIVs and consequently there is a breach of the principle of free movement of capital enshrined in Article 63 of the Treaty of the Functioning of the EU (TFEU).

The Spanish Supreme Court states that the non-compliance with the Spanish CIVs regulation does not justify the difference of treatment, being sufficient to prove the comparability with the general guidance contained in the UCITS Directives. In the case at stake, the Spanish Supreme Court positively considered the “serious and rigorous” efforts of the US RIC to evidence comparability with UCITS funds, stating that it even goes beyond the efforts made in other cases.

Regarding the second question, the Spanish Supreme Court confirms that the tax information exchange agreement contained in the Spain-US tax treaty is sufficient for the Spanish tax authorities to check the features of nonresident funds and determine their comparability to US funds.⁵

The applicability of the previous doctrine to the case at hand allows the Court to hold the following: (i) there is a breach of article 63 of the TFEU; (ii) the Fund is empowered to obtain the refund of the excessive DWHT paid; (iii) as long as there is a legal loophole regarding the means of proof for its comparability to the Funds established within the EU Directives, no additional excessive administrative burden can be placed on the fund if it has made its best efforts to evidence comparability with the documents considered relevant by him for this purpose (e.g. this may not be revisited now in the judicial court). In case of doubt, in other cases pending verification by the Spanish tax authorities, the latter can contact the relevant tax authorities (e.g., IRS) through the existing the tax information exchange agreement.

As the Spanish tax authorities have not used the tax information exchange agreement, the Court confirms the right to obtain the refund by the appellant.

Impact

This favorable decision concludes this milestone case for DWHT reclaims filed by US RICs. The positions contained in the Decision may potentially be extrapolated to other non-US funds, if certain conditions are met. A case-by-case comparability analysis is required in order to assess likelihood of success with other relevant DWHT reclaims.

Endnotes

1. Collective investment vehicles within the scope of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS); or the Directive in force in 2009, Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to UCITS.
2. Convention between the United States of America and the Kingdom of Spain for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, dated 22 February 1990.
3. Decision of the Supreme Court dated 27 March 2019 (5822/2017), regarding an Irish UCITS fund.
4. The Spanish Supreme Court bases its decision, among others, on three previous decisions: decision number 5822/2017 of 27 March 2019, decision number 634/2017 of 5 June 2018 and decision number 129/2017 of 5 December 2018.
5. Going forward, the tax information exchange agreement contained in the Spain-US tax treaty has been strengthened after the approval of the 2013 Protocol to the tax treaty, entering into force 27 November 2019.

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