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Global Tax Alert

Spanish Supreme Court issues favorable decision on UCITS reclaims

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Executive summary

The Spanish Supreme Court (*Tribunal Supremo*) issued, on 27 March 2019, a decision confirming that the Spanish tax legislation prior to the entry into force of Law 2/2010, of 1 March 2010, entails a restriction on the free movement of capital established by European Union (EU) legislation, insofar as it implies unfavorable tax treatment for nonresident UCITS funds[1] in comparison with Spanish Collective Investment Vehicles (CIVs).

Detailed discussion

Background

An Irish UCITS fund received dividends in Spain in 2008 which were subject to a 15% withholding tax (WHT) under the Ireland-Spain tax treaty. The claimant maintained that such tax treatment was discriminatory since Spanish CIVs were only subject to a 1% Spanish Corporate Income Tax (CIT). Therefore, it considered that there was an infringement of the free movement of capital which is prohibited by EU law.

It should be noted that, due to this discrimination, the Spanish Nonresident Income Tax (NRIT) Law was amended effective 1 January 2011, after which EU UCITS funds benefit from a 1% dividend WHT (by way of refund of excessive taxes) instead of the standard applicable domestic/tax treaty rate.

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The Decision

The High Court of Justice of Madrid (previous instance) had ruled in this case that there was no such violation of EU law since the foreign fund had not proved that it met the requirements of the Spanish CIT Law for Spanish CIVs to be taxed at the 1% CIT rate. Therefore, in the view of the High Court of Justice of Madrid, there was no discriminatory treatment between resident and nonresident entities since that difference in treatment was due to objective differences between both entities.

The Spanish Supreme Court has rejected this interpretation and, most importantly, considers that there was an infringement of the principle of free movement of capital enshrined in Article 63 of the Treaty on the Functioning of the European Union, since the Spanish NRIT Law did not provide for a mechanism for nonresidents to assert their right to the application of the reduced rate that the national legislation provided for Spanish tax residents. This consideration is based on the fact that, unlike the Spanish CIT Law, the Spanish NRIT Law did not provide for a specific procedure for the refund of the excess WHT, but rather nonresidents were required to follow the general procedure to claim undue taxes established in the Spanish General Tax Law. In this sense, the Supreme Court recognizes that tax revenues obtained by the Spanish Treasury (and paid by nonresident UCITS funds) were "originally undue," inasmuch as they resulted from the application of a domestic rule that violated EU law.

Impact

The judgment is decisive for UCITS funds that have borne excessive WHT in years prior to 2011 (as the Spanish NRIT Law was amended thereafter to end this discrimination). European non-UCITS funds, as well as CIVs located in non-EU countries may potentially claim the same arguments for dividend WHT reclaims before and after 2011.

Endnote

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).

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