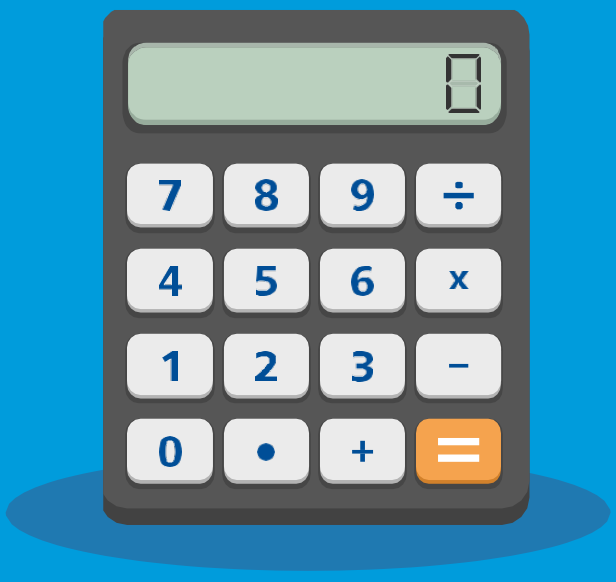
The Spanish Supreme court finds contrary to EU law the dividend WHT imposed to non-Spanish sovereign wealth funds

Tax Alert



April 2021

kpmgabogados.es
kpmg.es

The Spanish Supreme court finds contrary to EU law the dividend WHT imposed to non-Spanish sovereign wealth funds

The Spanish Supreme Court recently issued two decisions confirming that the withholding tax applied to Spanish sourced dividends received by non-resident sovereign wealth funds is contrary to the Community principle of free movement of capital. These decisions ease the way to obtain the refund of the withholding tax unduly applied to foreign sovereign wealth funds under the terms of the Spanish NRIT Law.

Spanish Supreme Court decisions No. 253/2021 and 290/2021

The claimant, in both cases a Norwegian public entity, had borne a withholding tax over the Spanish source dividends without the possibility of applying any exemption under Spanish domestic tax legislation. In contrast, pursuant to Article 9 of the Spanish CIT Law, the referred income would have been exempt if it had been received by the Spanish equivalent government bodies.

The Spanish Supreme Court, in its judgements, declared for the first time that the taxation, without exemption, in the NRIT on the dividends paid by entities resident in Spain to a non-resident sovereign wealth fund, is contrary to the principle of free movement of capital recognized in Article 63 of the Treaty in the Functioning of the European Union ("TFEU") and in Article 40 of the Agreement on the European Economic Area ("AEEA").

In order to reach this conclusion, the Spanish Supreme Court analyzed three issues: (i) the consideration of the investment activity of sovereign wealth funds as functions inherent to the exercise of public authority; (ii) the comparability of the situations of the claimant and the equivalent Spanish government body; and, (iii) the concurrence of general interest reasons justifying the different tax treatment.

(i) Functions inherent to the exercise of public authority

The Spanish Supreme Court, on the basis of the definitions envisaged in the Santiago Principles to sovereign wealth funds and in the European legal framework, concluded that what is really decisive is that sovereign wealth funds are investors in the capital market acting in direct competition with private investors, which neutralizes the sovereign element as a defining criterion of the activity developed.

Thus, being sovereign wealth funds financial investment vehicles, as any other investor in the capital market, they are subject to European Union regulations, resulting applicable the principle of free movement of capital.

(ii) Objectively comparable situations

In this regard, contrary to that claimed by the State Attorney, the Spanish Supreme Court considered that both resident and non-resident are sovereign wealth funds investing in financial assets in Spain, both belong to public entities and both have the same governmental purpose and, therefore, both are comparable.

However, they do not receive the same treatment: one is taxed on the profits obtained in Spain by virtue of Articles 13.1 f) 1º and 25.1 f) of the NRIT Law, and the other is not taxed, given the subjective exemption provided in Article 9.1 of the SCIT Law.

Being two comparable situations, the different tax treatment is only admissible to the extent that it is justified by general interest purposes. Otherwise, it would be understood as discriminatory treatment towards the non-resident sovereign wealth fund.

(iii) Concurrence of general interest reasons

In this sense, the State Attorney argued that the exemption envisaged in Article 9 of the Spanish Corporate Income Tax Law is justified by general interest reasons, related to the distribution of the taxing rights of the States and to the coherence of the tax system. In particular, preventing income from being used for purposes different from meeting future contributory pension commitments.

The Spanish Supreme Court did not object to this reason for establishment the Corporate Income Tax exemption. However, the Court considered that the exemption indirectly establishes a favorable treatment consisting in the non-taxation of a sovereign wealth fund that carries out an economic activity in the financial market on the grounds of its residence in Spain, which is not justified by general interest reasons of the tax system. As such, the discriminatory treatment responds to a purely economic and collection purpose.

KPMG input

It is expected that the Spanish Supreme Court decision will ease the path for those foreign sovereign wealth funds that have already claimed the refund of the Spanish withholding tax borne on Spanish sourced dividends and will reduce frequent litigation with the Spanish tax authorities in this area.

For those sovereign wealth funds who have not already filed any claim, the decisions shows that there is a clear opportunity to review the Spanish withholding tax borne during the years open to tax audit (generally speaking, those borne during the last 4 years since the filing of the return by the entity applying the withholding tax). In any case, the chances of success of this reclaim will highly depend on the comparability analysis that needs to be done specifically for each fund making the reclaim.

In principle, the claim would be viable both for EU and non-EU resident sovereign wealth fund as long as both could rely on the free movement of capital principle (as it has been expressly recognized by the Spanish Supreme Court in its ruling dated 7 December 2020 concerning the claims filed by a Canadian resident pension fund) .). In contrast, it is still subject to debate that non-EU sovereign funds could invoke the existence of an EU infringement in case they are operating under the free establishment principle. The potential application of the principles contained in the Spanish Supreme Court decision to other income streams different from dividends could be also explored.

Regarding future dividends, it appears unlikely that the exemption would be applied at source by the withholding agent (unless the domestic legislation is amended in order to include a specific exemption). Thus, in principle, it is expected that foreign sovereign fund would have to reclaim the refund of any excess of Spanish withholding tax applied.

KPGM Spain has a wide experience in assisting foreign sovereign wealth funds succeeding in withholding refund processes of foreign investors and may be able to assist in analyzing the chances of success and obtaining the refund of any eventual excess of Spanish withholding tax.

Contacts:

Victor Mendoza
Partner
KPMG Abogados, S.L.P.
Tel. +34 91 456 34 88
vmendoza@kpmg.es

Arturo Morando
Partner
KPMG Abogados, S.L.P.
Tel. +34 91 456 34 67
amorando@kpmg.es

Pedro Ruiz Correas
Director
KPMG Abogados, S.L.P.
Tel. +34 91 456 34 91
pedroruiz@kpmg.es

Irene Cao
Director
KPMG Abogados, S.L.P.
Tel. +34 91 456 34 69
irenecao@kpmg.es

Guillermo Rodriguez
Director
KPMG Abogados, S.L.P.
Tel. +34 91 451 31 94
guillermorodriguez@kpmg.es

KPMG Offices in Spain

A Coruña

Calle de la Fama, 1
15001 A Coruña
T: 981 21 8241
Fax: 981 20 02 03

Alicante

Edificio Oficentro
Avda. Maisonnave, 19
03003 Alicante
T: 965 92 0722
Fax: 965 22 75 00

Barcelona

Torre Realia
Plaça de Europa, 41
08908 L´Hospitalet de Llobregat
Barcelona
T: 932 53 2900
Fax: 932 80 49 16

Bilbao

Torre Iberdrola
Plaza Euskadi, 5
48009 Bilbao
T: 944 79 7300
Fax: 944 15 29 67

Girona

Edifici Sèquia
Sèquia, 11
17001 Girona
T: 972 22 0120
Fax: 972 22 22 45

Las Palmas de Gran Canaria

Edificio San Marcos
Dr. Verneau, 1
35001 Las Palmas de Gran Canaria
T: 928 33 2304
Fax: 928 31 91 92

Madrid

Torre de Cristal
Paseo de la Castellana, 259 C
28046 Madrid
T: 91 456 3400
Fax: 91 456 59 39

Málaga

Marqués de Larios, 3
29005 Málaga
T: 952 61 1460
Fax: 952 30 53 42

Oviedo

Ventura Rodríguez, 2
33004 Oviedo
T: 985 27 6928
Fax: 985 27 49 54

Palma de Mallorca

Edifici Ca´n de Segura
Avda. del Comte de Sallent, 2
07003 Palma de Mallorca
T: 971 72 1601
Fax: 971 72 58 09

Pamplona

Edificio Iruña Park
Arcadio M. Larraona, 1
31008 Pamplona
T: 948 17 1408
Fax: 948 17 35 31

San Sebastián

Avenida de la Libertad, 17-19
20004 San Sebastián
T: 943 42 2250
Fax: 943 42 42 62

Sevilla

Avda. de la Palmera, 28
41012 Sevilla
T: 954 93 4646
Fax: 954 64 70 78

Valencia

Edificio Condes de Buñol
Isabel la Católica, 8
46004 Valencia
T: 963 53 4092
Fax: 963 51 27 29

Vigo

Arenal, 18
36201 Vigo
T: 986 22 8505
Fax: 986 43 85 65

Zaragoza

Centro Empresarial de Aragón
Avda. Gómez Laguna, 25
50009 Zaragoza
T: 976 45 8133
Fax: 976 75 48 96