

Spanish Central Tax Court applies the doctrine of the ECJ Danish cases to deny withholding tax exemption on interest payments to EU lenders

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Executive summary

The Spanish Central Tax Court issued a Decision on 8 October 2019 (the Decision) confirming the rejection of the withholding tax exemption for interest payments by a Spanish debtor to a Dutch lender on the basis that the latter is not the beneficial owner of such payments.

The Decision gathers all the beneficial ownership and the prohibition of abuse concepts expressed by the European Court of Justice (ECJ) in the so-called Danish cases (See EY Global Tax Alert, [CJEU rules on application of Danish withholding tax on dividends and interest payments](#), dated 26 February 2019). In particular, the Central Tax Court held that for the Spanish domestic exemption to apply, the recipient must be the beneficial owner of the relevant income.

Detailed discussion

Background

The Spanish Nonresident Income Tax Law provides an exemption for interest payments to European Union (EU) lenders. This exemption was introduced before the EU Directive on Interest and Royalty Payments¹ was approved and provides for a wider scope of application.

Among other deviations from the Directive, the Spanish domestic exemption does not require that the recipient of the interest income is the beneficial owner, neither does it include a specific anti-abuse clause. It has been accepted by Spanish courts in the past that this exemption could only be challenged under the Spanish General Anti-Avoidance Rules (GAARs) and not merely by indicating that the recipient of the interest is not the beneficial owner.

The Spanish tax authorities and courts have taken the position that this domestic exemption must be interpreted in accordance with the Directive and the relevant ECJ case law, but whether this means that beneficial ownership of the interest income is required, remains a controversial issue. In fact, the Spanish National Court² (*Audiencia Nacional*), a higher instance than the Spanish Central Tax Court, has stated that “the notion of beneficial ownership as an anti-abuse restriction may not be presumed, but rather needs to be expressly stated in the law.”

The Decision

The Decision deals with the case of a Spanish debtor which has entered into a financing arrangement with its shareholder, a Dutch company, which immediately transfers the interest received to another company in the group which is an Andorra tax resident.

The Spanish tax auditors challenged the application of the exemption based on the lack of beneficial ownership condition, without resorting to application of a Spanish GAAR, and imposed penalties.

The Spanish payor, in turn, acknowledges that the Dutch lender is not the beneficial owner of the interest payments. However, it argues that since the Spanish domestic exemption does not include the beneficial ownership requirement, the tax auditors could only have challenged the application of the exemption based on the GAARs.

The Central Tax Court partially follows the approach of the ECJ in the Danish cases, considering some of the elements contained in it, stating that for the withholding tax exemption on interest payments to be applicable, the recipient must be the beneficial owner of such income. Moreover, in the

view of the Court, this is in line with the general aim of the Directive, which is to prevent the abuse of EU law. To reach its conclusions, the Decision reproduces a number of paragraphs of the ECJ's cases.

This is not aligned with the prior approach of the Spanish National High Court, which in a similar case concluded that the application of the domestic withholding tax exemption could only be challenged under Spanish GAAR (for which the notion of beneficial ownership is one of the elements to be considered, but not the only one). The reasoning of the National High Court would be in line with the fact that the wording of the Spanish exemption differs from that of the Directive and does not include beneficial ownership as a requirement for its application.

Further, the Decision also points out that while the tax authorities must evidence the existence of an abuse, the burden of proving who the actual beneficial owner is lies on the taxpayer.

Impact

This is the first time the Spanish tax courts have followed the approach of the ECJ in the Danish cases to reach a conclusion on the availability of the domestic exemption for interest payments to EU lenders.

Although this Decision can be challenged before judicial courts, it is anticipated that both the Spanish tax authorities and tax and judicial courts will be following the ECJ's approach on economical beneficial ownership and indicators of abuse.

This being said, it remains to be seen whether the approach of considering beneficial ownership as a material requirement of the domestic exemption on interest payments will be upheld in the future or whether the courts, and in particular the National High Court, will continue with the approach followed in the past that this domestic exemption can only be challenged under Spanish GAARs.

EY will closely monitor this case, as well as any other cases in which this matter is being discussed.

Endnotes

1. Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.
2. Spanish National High Court (*Audiencia Nacional*), decision number 4707/2017 dated 31 October 2017.

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EYG no. 005366-19Gbl

1508-1600216 NY
ED None

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