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Global Tax Alert

The European Union General Court issues decision on Spanish tax amortization of financial goodwill for foreign shareholding acquisitions

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Executive summary

On 15 November 2018, the European Union (EU) General Court (GC) issued a judgment on seven claims against the decisions issued by the EU Commission on the Spanish regime allowing the tax amortization of the financial goodwill resulting from the acquisition of foreign companies.[1]

The GC has upheld the decisions based on the position that the tax amortization of the financial goodwill constituted State aid which is incompatible with the EU internal market, given that the special tax regime was of a "selective nature."

The GC has also confirmed that transactions performed before 21 December 2007 should continue to benefit from this tax regime, so as to protect the legitimate expectations of the beneficiaries.

These judgments can be appealed before the Court of Justice of the EU (CJEU) within two months from the date in which they were communicated to the appellants.

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Detailed discussion

Background

As a general rule, the difference between the price paid for the acquisition of a company and the fair market value (FMV) of its assets (the so-called "financial goodwill") can only be amortized for tax purposes if a business combination (merger) takes place.

However, as of 1 January 2002, the Spanish Corporate Income Tax Law included a provision setting forth that Spanish companies were entitled to treat the amortization of such financial goodwill as tax deductible in the case of an acquisition of, at least, 5% share capital in a foreign company.

The compatibility of this rule with the EU internal market was challenged by the EU Commission, which issued two decisions on 28 October 2009 (with respect to EU acquisitions) and 12 January 2011 (with respect to non-EU acquisitions). These decisions stated that this tax regime provided an advantage for Spanish companies acquiring foreign targets, when compared with non-Spanish competitors. Such advantage constituted, in the eyes of the EU Commission, State aid and was declared as incompatible with the EU internal market. The existence of legitimate expectations with respect to transactions performed before 21 December 2007 was already established in these decisions.

The decisions were challenged by some of the beneficiaries before the GC, which in a judgment dated 7 November 2014, annulled them on the basis that the EU Commission had failed to establish the selective nature of the tax regime.

The CJEU reviewed the GC judgments, annulled them on 21 December 2016, and referred the cases back to the GC.

A third decision was issued by the EU Commission in October 2014, relating to the new interpretation of the article governing the tax deductibility of financial goodwill with respect to acquisitions performed through holding companies; this decision has also been challenged, although on different grounds than the other two decisions.

The GC's judgment

In these recent judgments the GC followed the guidelines that the CJEU established in the 2016 annulment decision on how the three-step method needs to be applied to determine whether a tax measure is of a selective nature.

In particular, the GC reached the conclusion that a tax measure may be selective even if there are no restrictions to the application of such measure, just because it introduces a difference in treatment between the companies which have decided to undertake a certain transaction (for instance, the acquisition of a foreign target) instead of another transaction (such as the acquisition of a Spanish target). This approach is extremely innovative, since the "selective" nature of a tax measure had not previously been assessed on the basis of the comparison with other taxpayers undertaking a different transaction.

Furthermore, the GC does not consider that this difference in treatment can be justified by the need to ensure the coherence of the Spanish tax system. In this regard, the Spanish Tax Authorities had originally argued, when the financial goodwill was first challenged, that given the difficulties for cross-border mergers, allowing for the tax deductibility of this financial goodwill was the only alternative to provide an equivalent tax treatment to the acquisition of foreign targets. The Court expressly rejected this argument and confirmed the selective nature of this special tax regime.

Finally, the GC confirmed that all beneficiaries that applied the amortization based on acquisitions that took place before 21 December 2007 may still benefit from the aid as they had legitimate expectations. That is the case because through the answer given to certain parliamentary questions in 2005 and 2006, the Commission provided them with precise assurances that the contested measure did not constitute unlawful State aid.

Implications

Given that the GC judgments can be subject to appeal before the CJEU, it can reasonably be expected that the appellants will appeal them and new judgments by the EU higher court can be expected. EY will continue to closely monitor the court proceedings with respect to these cases.

Moreover, it is likely that the proceedings are aimed at recovering the tax benefits from the appellants, which are not covered by the legitimate expectations, which had been interrupted by the GC's proceedings. The technical position of the taxpayers in those proceedings should be reviewed and updated, to address the additional arguments included by the GC in these new judgments.

Finally, the impact that these judgments by the GC will have with respect to the proceedings related to the third decision issued by the EU Commission with respect to acquisitions through holding companies remains to be seen.

Endnote

1. See EY Global Tax Alert, *CJEU refers back to General Court EU State aid case re: Spanish regime on tax amortization of financial goodwill for foreign shareholding acquisitions*, dated 21 December 2016 regarding the previous phase of this proceeding.

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