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Global Tax Alert

Spanish Supreme Court issues favorable decision on reclaims by non-Spanish pension funds

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Executive summary

The Spanish Supreme Court (*Tribunal Supremo*) issued a favorable decision confirming the right of a Canadian pension fund to obtain a refund of the Spanish withholding tax borne. The decision, dated 22 December 2020, was recently published.[1]

The Canadian pension fund filed a reclaim to obtain a refund of the difference between the dividend withholding tax (DWHT) borne and the exemption applicable to Spanish pension funds, insofar as it implies discriminatory tax treatment for nonresidents in comparison with Spanish pension funds.

The Spanish Supreme Court concluded that, at the time (2008), there was no regulatory framework that provided an equal treatment between Spanish and non-Spanish pension funds and, consequently, there was a breach of the principle of free movement of capital under European Union (EU) Law. Currently, the Spanish tax law does allow EU comparable pension funds to benefit from the exemption, but not non-EU pension funds.

Also, the Spanish Supreme Court confirmed that the tax information exchange agreement contained in the Canada-Spain Tax Treaty[2] is sufficient for the Spanish tax authorities to check the features of Canadian pension funds and determine their comparability to Spanish pension funds.

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Detailed discussion

Background

The Canadian pension fund in the case at hand filed a reclaim to obtain a refund of the difference between the DWHT borne in 2008 (after treaty relief, a 15% DWHT) and the exemption provided in the Spanish Corporate Income Tax (CIT) rate applicable to Spanish pension funds, insofar as it implies discriminatory tax treatment for nonresidents in comparison with Spanish pension funds, contrary to EU Law.

The Spanish Nonresident Income Tax (NRIT) Law was amended in 2011, after which EU comparable pension funds benefitted from an exemption (by way of a refund of excessive taxes) instead of the standard applicable domestic/tax treaty rate. However, this exemption was not available to non-EU pension funds at the time analyzed and it is still not available.

The Spanish Supreme Court issued a decision earlier in 2019,[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[4] funds in comparison with Spanish Collective Investment Vehicles (CIVs).

Later on, the Spanish Supreme Court issued another decision,[5] in a case led by EY, in connection with the right of a non-EU CIV – in particular, a United States (US) Regulated Investment Company (RIC) – to obtain a refund of the Spanish DWHT paid in excess of what a Spanish CIV would have borne.

The applicability of the previous doctrine to the case of the US RIC allowed the Court to hold the following: *(i)* there is a breach of article 63 of the Treaty of the Functioning of the European Union; *(ii)* the Fund is empowered to obtain the refund of the excessive DWHT paid; *(iii)* as long as there is a legal gap 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., in the case of the US RIC, the Internal Revenue Service) through the existing tax information exchange agreement.

This new decision further recognized that the same conclusion can be drawn regarding non-EU pension funds, if certain conditions are met, as further explained below.

The Decision

The Spanish Supreme Court addressed two specific matters: (i) whether a Canadian pension fund should be compared to (the features of) a Spanish pension fund as established in the Spanish domestic law; and (ii) whether the tax information exchange agreement established in the Canada-Spain Tax Treaty is a valid tool to allow the Spanish tax authorities to verify the features of the Canadian pension fund to assess comparability.

The Spanish Supreme Court largely refers to the US RIC decision in its analysis, including a large excerpt of the same, which in turn includes references to EU case law.[6]

The Spanish Supreme Court reiterated the arguments in the US RIC decision.

The Spanish Supreme Court confirmed the position of the taxpayer, stating that the tax information exchange agreement contained in the Canada-Spain tax treaty allowed the Spanish tax authorities to request the Canadian tax authorities for information on the nature of the taxpayer, in order to assess the equivalence with Spanish pension funds subject to Spanish domestic legislation to consider the dividends obtained by the Canadian pension fund as exempt, since the domestic tax law in force at the time did not condition the tax advantage for non-EU countries on a number of requirements, but rather did not allow such tax advantage in any case, merely by reason of tax residence outside of Spain.

The Spanish Supreme Court highlighted that lower courts had not questioned the validity of the proof put forward by the taxpayer and admitted that such documents referred to the functioning and structure of Canadian pension funds and the rules governing the funds and that it even includes a certification that, as from 2011, is required for EU/European Economic Area pension funds. Such certification – referred to comparability to Spanish pension funds – was not required before 2011.

Regarding the second question, the Spanish Supreme Court confirmed that the tax information exchange agreement contained in the Canada-Spain tax treaty is sufficient for the Spanish tax authorities to check the features of nonresident funds and determine their comparability to Canadian pension funds.[7]

Impact

This decision concludes another favorable step in the area of reclaims filed by non-Spanish funds.

In the case of Canadian pension funds, the Canada-Spain tax treaty was amended by a Protocol.[8] Since it became effective, Spanish-source dividends obtained by a Canadian tax resident pension or retirement plan are exempt if certain conditions are met. On the other hand, a potential procedural route (to be further explored) may be financial liability against the State (*responsabilidad patrimonial del Estado*), which allows the reclaim of years that are statute-barred.

Non-Spanish pension funds that are not Canadian may also wish to explore potentially available routes to obtain the refund of taxes borne.

Other non-CIV funds such as sovereign funds or even national banks and foundations may wish to consider the opportunity that this decision may bring to their reclaims. The national legislation provides certain subjective exemptions or reduced/nil tax rates and these entities may credit, directly in their Spanish CIT assessment, any withholding taxes borne. However, so far, comparable nonresident entities lack a mechanism to claim comparability and assert their right to the application of a similar reduced rate/exemption.

EY has the experience to assist in the review of current reclaim opportunities. A case-by-case analysis is required in order to assess the viability of such reclaims.

Endnotes

1. The Spanish Supreme Court later issued additional decisions for the same taxpayer, ruling on DWHT reclaims for years 2007, 2009 and 2010. All replicate this same reasoning.
2. Convention between Canada and Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, dated 23 November 1976.
3. Decision of the Supreme Court dated 27 March 2019 (5822/2017), regarding an Irish UCITS fund.
4. UCITS: Undertakings for the Collective Investment in Transferable Securities.
5. Decision of the Supreme Court dated 13 November 2019 (3023/2018), regarding a US RIC.
6. European Court of Justice Decision c-190-12, Emerging Markets, among others.
7. The Spanish Supreme Court later issued additional decisions for the same taxpayer, ruling on DWHT reclaims for years 2007, 2009 and 2010. All replicate this same reasoning.
8. Convention between Canada and Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, dated 23 November 1976.

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