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Spanish Supreme Court concedes dividend withholding tax refund to US investment funds

Legal flash Tax

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- In its landmark decision of November 13, 2019, the Supreme Court has ruled that the EU free movement of capital imposes a non-discriminatory tax treatment between Spanish investment funds and comparable US investment funds.
- Those US investment funds are now entitled to obtain a refund on dividend withholding taxes paid (usually 15%) over the tax rate applicable to domestic funds (1%).
- The Supreme Court's reasoning could be applied by investment funds and other entities (insurance companies and pension funds for which we have recently obtained positive decisions from Regional High Court of Justice), which are resident in third countries that have signed valid exchange of information agreements with Spain.
- All claims should consider the Spanish statute of limitations regime of four years.

The Supreme Court decision of November 13, 2019 confirms that US investment funds are entitled to the Spanish dividend withholding tax benefits applicable to Spanish funds (and EU UCITS) under free movement of capital (article 63 TFEU).

Following its reasoning regarding investment funds resident in the EU, the Supreme Court confirms that, because of the conditions under which the dividend withholding tax was levied on dividends paid to foreign investment funds, Spanish legislation breached the free movement of capital. While a domestic fund meeting certain requirements can apply a specific tax regime of a tax rate of 1% (with any amount withheld on top refunded), a foreign investment fund bears dividend withholding tax as the definitive tax in all cases.

Following the Supreme Court's ruling, foreign investment funds with portfolio investments in Spain can apply for the refund of amounts withheld exceeding 1% on dividends received, even if they are resident in a non-EU country such as the US. This is because the free movement of capital also applies to third state.

The Supreme Court also states that the comparability analysis between foreign and domestic funds must not be based on the domestic legislation on investment funds, but on European legislation (Directive 85/611/EEC or Directive 2009/65/EC). Particularly, it cannot be required that foreign and domestic funds be identical, and they only need to be similar or equivalent.

The taxpayer should provide the relevant evidence for this comparability analysis, and in case of doubt, the Spanish tax authorities must take into account the exchange of information clause included in the double tax convention signed between Spain and the US. Implicitly, the court admits that, because of this exchange of information obligation, the restriction on the free movement of capital cannot be justified.

This Supreme Court judgment establishes the legal framework that the lower courts should follow where similar tax litigations are pending. It reinforces the right of non-EU investment funds to file new applications for the refund of the dividend withholding taxes suffered within the tax statute of limitations (four years). In certain cases, the right to claim could include even prior years.

Although the judgment only deals with investment funds, its principles, when read in combination with the previous case law of both the EU Court of Justice and the Spanish Supreme Court, open the door for other international investors (such as pension funds and insurance companies resident in third states) to claim the refund of Spanish dividend withholding taxes. We have recently obtained positive decisions from the Regional High Court of Justice for US pension funds.

The success of these litigations will depend on the strength of the evidence that claimants can provide on their comparability to EU investors.

For further information on this landmark case, please refer to your contact person at Cuatrecasas.

For additional information, please contact Cuatrecasas.