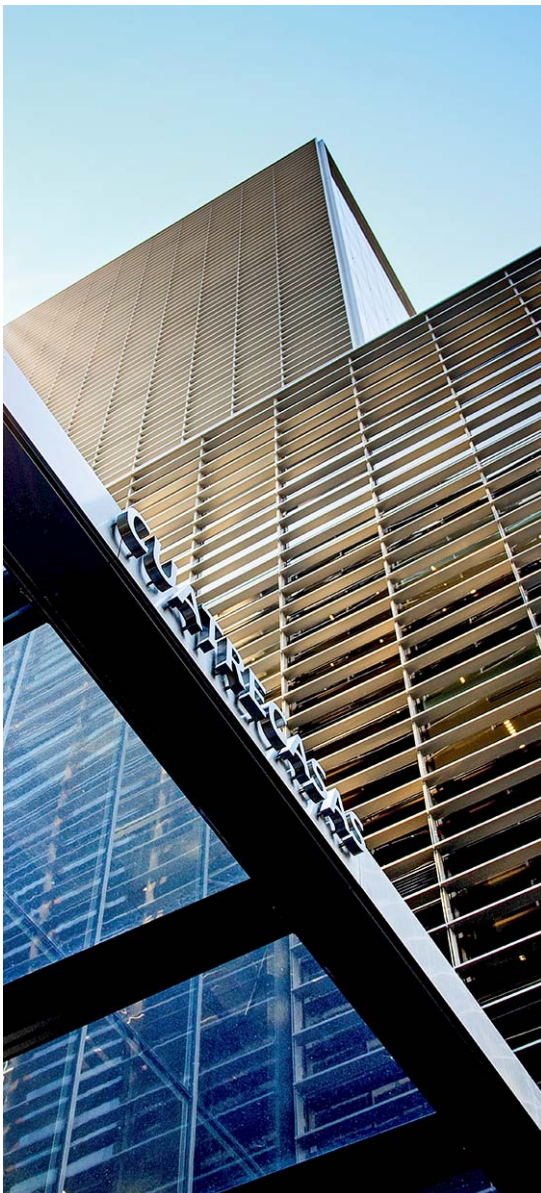

SUPREME COURT CONFIRMS EQUAL TREATMENT FOR EU AIFs AND SPANISH FUNDS

Supreme Court rules in favor of dividend withholding tax refunds for EU Alternative Investment Funds.

Spain - Legal flash

May 2023



Key aspects

- > The Supreme Court puts an end to the discrimination of EU AIFs in its recently published judgement of April 25, 2023, in a case advised by Cuatrecasas.
- > Spanish AIFs are taxed at a 1% rate on dividends received from Spanish entities while foreign AIFs are subject to a final 19% withholding tax (that may eventually be reduced under the relevant tax treaty).
- > The Supreme Court has clarified which features a non-Spanish AIF should have in order to apply the 1% tax rate, abandoning the traditional criteria applied by the tax authorities.



Scope and consequences of the judgement

The Supreme Court has ruled that Alternative Investment Funds (“AIF”) established in the European Union (“EU”) should be treated in the same way as Spanish funds or UCITS funds. The determining criterion for comparability is the very fact that they are qualifying funds. These funds just need to prove that they (i) are open-ended entities, (ii) have the appropriate authorization, and (iii) are managed by an authorized management company under Directive 2011/61/EU.

The Spanish Corporate Income Tax (“CIT”) Act provides for a reduced tax rate of 1% (rather than the general 25% rate) for all Spanish funds that qualify as such for Spanish regulatory purposes.

In contrast, the Non-Resident Income Tax (“NRIT”) Act, which applies to foreign funds, initially did not provide for a reduced rate equivalent to that of the CIT Act. Instead, the general rates applied (currently 19%). Although effective taxation in Spain could sometimes be reduced under a tax treaty (typically to 15%), the reduced 1% rate was never applicable.

In 2010, the NRIT Act was partially amended to include a reduced rate of 1% on Spanish-source dividends for funds qualifying for Directive 2009/65/EC (UCITS).

In other words, non-Spanish non-UCITS funds, whether established in or outside the EU, remained subject to a different much worse tax treatment.

In 2019, the Spanish Supreme Court ruled that the different tax treatment applied to non-EU funds was discriminatory and violated the free movement of capital under article 63 of the Treaty on the Functioning of the European Union (judgements of November 13, 2019 (appeal 3023/2018) and of November 14, 2019 (appeal 1344/2018)).

However, the issue remained unresolved for EU AIFs: the Spanish tax authorities, the regional and central tax courts and the Higher Court of Justice of Madrid were still denying the application of the 1% rate, whereas the Court of Appeals (*Audiencia Nacional*), in a case led by Cuatrecasas, had upheld the taxpayers’ claims in its judgement of July 30, 2021 (appeal 709/2019).

Recently, the Supreme Court has issued several judgments that have established new case law regarding the tax treatment of AIFs based in the EU. These include the judgments of April 5, 2023 (appeal 7260/2021) and of April 25, 2023 (appeal 8494/2021). The latter case concerned the favorable Court of Appeals judgement obtained by Cuatrecasas, which was subsequently appealed by the Attorney General of the State.

Under the new case law, it is stated that since EU AIFs are in a comparable situation as Spanish funds, the restriction of free movement of capital is not justified and consequently they should receive the same tax treatment as Spanish funds (i.e., 1% taxation on dividends), assuming they are in a comparable situation as Spanish funds.

The Supreme Court rejects the comparability parameters that the Spanish tax authorities have traditionally used, which involve a literal application of the regulatory requirements that Spanish AIFs must meet, such as having a minimum of 25 investors or a minimum amount of equity.



Instead, the Supreme Court considers that the essential issue is the very nature of being an AIF and establishes the following criteria:

➤ Open-ended nature

The fund raises capital contributions from the general public.

Any eventual restrictions on access for professional or qualified investors do not alter the fund's open-ended nature. The only factor that would preclude a fund from being considered open-ended would be, for example, that it could only receive contributions from certain family members.

➤ Authorization

The fund is authorized to operate in its country of establishment by the regulatory body equivalent to the Spanish National Securities Market Commission (CNMV).

➤ Management

The fund is managed by an entity authorized to operate as an AIF manager under Directive 2011/61/EU.

The fund is responsible for providing evidence that the above criteria are met. However, the fund cannot be required to provide evidence that is disproportionate or extraordinarily difficult to obtain.

If the Spanish authorities have any doubts regarding the documentation provided to prove comparability, they must use the existing mechanisms for exchanging information.

For additional information, please contact our [Knowledge and Innovation Group](#) lawyers or your regular contact person at Cuatrecasas.

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