The Supreme Court confirms that Spanish tax legislation discriminates against certain non-resident Non-UCITS Funds

Tax Alert

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The Supreme Court rules that the differential treatment of dividend withholding tax for foreign and domestic Non-UCITS Funds infringes the EU principle of free movement of capital.

The Supreme Court has recently ruled, in five judgments issued between 5 and 11 April 2023, that the Spanish tax regulations run contrary to the principle of free movement of capital set forth in Article 63 of the Treaty on the Functioning of the European Union as they lead to unjustified differential treatment of certain non-resident Non-UCITS Funds with respect to Spanish-resident non-UCITS Funds.

Likewise, it has established the requirements that non-resident Non-UCITS Funds must comply with in order to obtain a refund of the excess Spanish withholding tax borne with respect to domestic Non-UCITS Funds.

According to the Spanish tax regulations in force, Non-UCITS Funds resident in Spain are taxed at rate of 1%, while non-resident Non-UCITS Funds are subject to a rate of 19% unless a double taxation treaty ("DTT") reduced rate or exemption applies.

In this context, the Spanish Supreme Court has recently held that this differential treatment runs contrary to the principle of free movement of capital enshrined in Article 63 of the Treaty on the Functioning of the European Union, as the two situations are objectively comparable.

Furthermore, the Supreme Court has confirmed that non-resident Non-UCITS Funds must meet the following requirements to be entitled to claim a refund of Spanish withholding tax:

i. They must raise capital contributions from the public in general, notwithstanding the possibility of limiting access to professional or qualified investors.

ii. They must be authorised in their country of origin or residence by the competent supervisory authority.

iii. They must evidence that they are managed by a duly authorised entity in their country of origin or residence, as an Alternative Investment Fund Manager, under the terms of Directive 2011/61/EU.

According to the Supreme Court, the burden of proof as regards compliance with the above-mentioned requirements lies with the non-resident Non-UCITS Fund. However, the Court notes that since Spanish legislation does not establish the specific proof that is to be furnished by non-resident Non-UCITS Funds, it is not possible to request means of proof or

certificates that are entirely equivalent to those required of resident Non-UCITS Funds, or which are disproportionate or extraordinarily difficult to obtain.

The Court has also held that, where the tax authorities have reasonable doubts as to a Fund's compliance with the above requirements, they should make use of the information gathering powers available under the applicable DTT and the automatic exchange of information mechanisms in the European Union.

Finally, the Court has ruled that the restriction on the free movement of capital can only be neutralised by means of a DTT in cases where the non-resident Non-UCITS Fund is entitled to deduct the Spanish withholding tax paid in excess of 1% (the tax rate applicable to resident Non-UCITS Funds) from the tax due in its state of residence. This is not usually the case for non-resident Funds, as they are generally eligible for a beneficial tax rate of less than 19% and, as such, cannot apply the tax credit for withholding taxes incurred abroad.

Potential reliance by non-resident Non-UCITS Funds on this ruling will depend on the specific characteristics of the Fund in question and its ability to meet and demonstrate fulfilment of the parameters determined by the Spanish Supreme Court. Accordingly, we strongly recommend that non-resident Non-UCITS Funds perform a proper individual analysis to confirm whether or not they are entitled to claim, and eventually obtain, a refund from the Spanish tax authorities.

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