

CASES & LACAMBRA

SUPREME COURT OF SPAIN RULING ALLOWS US INVESTMENT FUNDS TO REQUEST A REFUND OF WITHHOLDING TAX ON DIVIDENDS FROM THEIR INVESTMENTS IN SPAIN

The Spanish Supreme Court, in a decision dated November 13, 2019, has confirmed the possibility of US investment funds to request a refund of withholding tax applied on dividend distribution from their investments in Spain. This means that United States-based investment funds (US RIC) will be able to apply for reimbursement of the excess amounts withheld over the last 4 years.

The excess withholding is calculated as the difference between the withholding rate applied to dividends received (generally, 15%) and 1%. That is to say, US funds can request reimbursement of up to 14% of the gross dividends received.

The foregoing extends to any investment fund based outside the European Union (EU), provided it can be established that the legal framework applicable in the foreign territory is equivalent to the European framework (1985 and 2009 EU Directives relating to Undertakings for Collective Investment in Transferable Securities or UCIT).

In its opinion, the Supreme Court ruled that the difference in treatment of the taxation of dividends received by Spanish and American investment funds according to Spain's Non-resident Income Tax Law constitutes an infringement of the EU principle of free movement of capital as stated in Article 63 of the Treaty on the Functioning of the European Union, which is applicable to non-EU funds that receive dividends from Spanish companies.

The restriction on the free movement of capital is produced by the unequal tax treatment in Spain of American funds and Spanish funds and other Spanish Collective Investment Schemes (Instituciones de Inversión Colectiva or IIC) on profits realized in Spain, even though the regulatory framework for this type of entity

is not identical in both countries.

Under existing regulations, while Spanish IICs and investment funds were taxed at 1%, American funds were taxed at a higher rate because of withholding on dividends on their Spanish investments (generally, at a rate of 15%). Therefore, the affected taxpayer has a right to request reimbursement of the overpayment.

In addition, while Spanish investment funds could request a refund of any withholding over 1% on their Corporate Income Tax return, for US investment funds, the withholding on Spain source dividends is considered a final payment and not a payment on account, so the excess between 1% and the actual withholding rate could not be offset or recovered.

However, this ruling opens the door for US-based investment funds, as well as other non-EU funds, that have had dividends withheld at a rate above 1% to request reimbursement of the excess for the last 4 tax years, as well as applicable interest, due to the infringement by the Spanish law of the principle of free movement of capital applicable to investment funds established outside the EU.

The opinion states that the taxpayer must prove the equivalence of the regulatory framework, that is, that the regulations or legal framework applicable to the nonresident investment fund is equivalent or similar to that of the EU, although if there is any doubt, it will correspond to the Spanish authorities to obtain the necessary information from the US authorities in order to be able to confirm said equivalence.

TRENDING NOW

There is a statute of limitations of 4 years to request a tax refund on prior year taxes, so it is important to conduct a review of the withholding taxes suffered by American funds derived from dividends distributed by Spanish companies with the aim of initiating the reimbursement process with the briefest possible timetable due to the existing 4-year statute of limitations.

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