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A legal update from Dechert's International and Domestic Tax Group

Tax Refund Opportunity in Spain for EU Pension/Investment Funds

EU pension funds and investment funds that have invested in Spanish dividend yielding equities should consider the possibility of seeking a refund of tax previously incurred on such dividends.

Background

Under domestic Spanish tax law, Spanish pension funds are taxed at a 0% rate and investment funds are taxed at a 1% rate on the income they derive.

In contrast, until recently, EU pension and investment funds were subject to the general rules relating to the taxation of non-residents in Spain on dividend income. This meant that, in general, the rate payable on dividends derived by these entities amounted to 18% (19% since January 1, 2010). Such rate could only be reduced through the application of the Tax Treaty signed by Spain and the country where the pension or investment fund was resident but it still resulted in a higher burden than that borne by Spanish entities on the same income and was therefore discriminatory in application.

Discrimination Action

The existence of the above discrimination against pension and investment funds incorporated in another EU country vis-à-vis Spanish comparable entities, led the EU Commission to refer Spain to the EU Court of Justice on November 27, 2008.

Although the Court has not provided its resolution yet, the existence of other precedents (such as the Aberdeen Property Case) where the Court has already ruled that national legislations discriminating against investment funds of other EU countries is not compatible with the freedom of movement of capital, stipulated by article 56 of the EU Treaty, has resulted in the Spanish tax authorities amending the domestic tax legislation.

Therefore, since March 2010, two new exemptions have been introduced as follows:

- Dividends derived by EU pension funds (or their permanent establishments situated in other EU countries) will be exempt in Spain provided that they are comparable to Spanish pension funds. To this end, the following conditions must be met:
  - The pension fund must provide a complementary consideration to the beneficiary upon his retirement, death, incapacity or physical dependence.
  - Employer's contributions that are made to the fund on behalf of company's employees must be imputed to them for tax purposes. The right to receive the consideration related to the contribution made to the fund must be irrevocably transferred to the employee.
  - Contributions and profits derived from those funds can only be taxed once the beneficiary receives a payment as a result of any of the circumstances above-referred (i.e. retirement, death, incapacity or physical dependence).
- Dividends derived by EU investment funds regulated by the Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the

coordination of laws, regulations and administrative provisions relating to Undertakings for Collective Investment in Transferable Securities ("UCITS") will only be taxable at the tax rate applicable to Spanish funds (1%).

Several recent court resolutions of the Audiencia Nacional (Spanish National Court) have admitted the right of certain Dutch pension funds, comparable to Spanish funds, to obtain the refund of withholding taxes they have borne on dividends received from Spanish companies. The Court acknowledges that the criterion of the EU Court of Justice and the amendment of the Spanish law can be effective also retroactively.

Therefore, refund opportunities arise for any pension fund (comparable to a Spanish one on the basis of the above) or investment fund (with the status of "UCITS") established within the EU that has borne withholding taxes on dividends received from Spanish companies.

Conclusion

Qualifying EU pension or investment funds that have derived dividends from Spanish companies should consider filing a refund claim with the Spanish Tax Authorities. In the light of the above, the Spanish Tax Authorities should be obliged to refund the withholding taxes borne by those entities including late interest.

According to Spanish law, the statute of limitation period to claim a refund is 4 years and accordingly any refund claim should be made within this period..

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We are grateful to Carlos J. Rodriguez of Messrs Garrigues (carlos.j.rodriguez@garrigues.com) for bringing these Spanish tax law changes to our attention.

Practice group contacts

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