EU Direct Tax News Alert

The Central Administrative Tribunal applies the ECJ's Danish cases to deny the withholding tax exemption on dividends

The Central Administrative Tribunal (i.e., administrative body) has recently published a ruling in which it applies the doctrine from the ECJ in the Danish cases to a Spanish case denying the withholding tax exemption on dividend payments to EU parent companies.

Background

A Spanish company paid dividends to a Luxembourg company, both belonged to the Qatari Sovereign Fund.

The Spanish law implementing the EU Parent-Subsidiary Directive provides with a withholding tax exemption on dividends payments if some conditions are met, namely a minimum participation and a minimum holding period. Thus, the beneficial ownership is not included as a material requirement. However, that withholding tax exemption could be precluded in those cases in which the majority of the voting rights of the EU company receiving the dividends were, directly or indirectly, held by non-EU persons.

The wording of the anti-avoidance provision applicable at the time of the facts addressed in the resolution stated that the withholding tax exemption would not be precluded if one of the following three conditions were met: (i) the EU parent company receiving the dividends carried on a business activity directly related to the business activity of the Spanish subsidiary; (ii) the business purposes of the EU parent company was to manage the subsidiary with the necessary human and material means; or (iii) the EU parent company proved that it was incorporated under valid economic reasons and not to get access to the dividend withholding tax exemption in a fraudulent way.

Doctrine of the case

The Luxembourg company argued that it benefitted from the withholding tax exemption since it was incorporated under valid economic reasons, but the tax inspector and the Central Administrative Tribunal denied that statement by arguing that:

a) The legal domicile of the Luxembourg company was at an external service provider in Luxembourg;
b) Some of the directors of the Luxembourg company were also employees of the same service provider in Luxembourg;
c) The Luxembourg company did not have any employee;
d) The Luxembourg company was not the beneficial owner of the dividends because it passed them on to the Qatari Sovereign Fund, as ultimate shareholder, through dividend distributions and repayment of debt;
e) The Qatari Sovereign Fund took benefits from the fact of funding the structure through CPECs in Luxembourg.

The Luxembourg company tried to reinforce its position to justify the applicability of the withholding tax exemption, although it was not finally admitted. Some of the arguments used by the Luxembourg company were:

a) The Luxembourg company was used as a regional investment platform, in which the Spanish investment represented less than 50% of the total portfolio;
b) The Luxembourg company acquired the shares in the Spanish company almost a year and a half after its incorporation;
c) At the time of acquiring the shares in the Spanish company, the Luxembourg company had already made other investments in jurisdictions other than Spain;
d) Dividends received from the Spanish company represented only one portion of the total income from the different investment in different jurisdictions;
e) The application of the most favorable treatment of non-tax rules applicable to EU companies, i.e., laws applicable within the energy sector.

The application of the reduced withholding tax rate on dividend payments under the Spain-Luxembourg Double Tax Treaty was also denied since the Luxembourg company did not qualify as the beneficial owner.

Takeaway

Although this resolution can be appealed before the competent Spanish court, it is clear that the current approach from the Spanish tax authorities is to challenge the applicability of the withholding tax exemption on dividend payments based on the beneficial ownership and the applicable anti-avoidance provision, including the abuse of rights as a general principle of EU Law.

There is no view on whether Spanish courts and tribunals will admit and apply the approach from the tax authorities including the Central Administrative Tribunal. Thus, non-resident investors holding participations in Spanish companies and receiving dividends should revisit their corresponding investment structures to mitigate any potential impact deriving from the new resolution on the matter from the Central Administrative Tribunal.

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