Abuse of Parent-Subsidiary Directive? Spanish High Court places burden of proof on tax authorities

Routing Spanish dividends to a non-EU shareholder via a Luxembourg holding company and thereby avoid Spanish withholding tax. Does that stand the anti-abuse test? On 25 May 2021 the Spanish National High Court (*Audiencia Nacional*) delivered its ruling on the application of the EU Parent Subsidiary to the distribution of dividends by a Spanish subsidiary to its Luxembourg shareholder, which was controlled by a non-EU resident Canadian pension fund.

This ruling constitutes an important pronouncement. It is a turning point in the case-law of the Spanish Supreme Court and the Spanish National Court on the interpretation of the anti-abuse provision contained in the Spanish implementation of the EU Parent Subsidiary Directive. Both courts had previously ruled that the taxpayer has the burden of proving the absence of abuse or fraud in cases where a Spanish company distributes dividends to an EU-resident parent entity controlled by third country residents.

The EU Parent Subsidiary Directive: principles, exceptions and safe-harbour provisions

It is well known that the EU Parent-Subsidiary Directive (90/435/EEC) provides for a 0% withholding tax on dividends paid between entities resident in EU Member States under certain conditions.

The EU Directive, as implemented by Spain, includes an anti-avoidance provision that excludes the withholding tax exemption on distributions made to direct EU shareholders when the majority of the voting rights of the EU parent company are directly or indirectly owned by non-EU residents. However, in such case, the 0% dividend withholding tax would still apply if one of the following conditions (the so-called safe harbours) is satisfied:

- The EU parent entity is in fact conducting a business directly linked to the Spanish subsidiary's business;
- The business purpose of the parent entity is the management of the subsidiary with the necessary organization of human and material resources; or
- Evidence can be given that the EU parent was incorporated on sound economic reasons and not only to benefit from withholding tax exemption.

Spanish Revenue denied refund to Luxembourg shareholder due to anti-avoidance provisions

In years 2009 and 2010, a Spanish company paid dividends to its Luxembourg parent company (LuxCo) applying a 15% dividend withholding tax. LuxCo is a holding company engaged in the purchase, sale and management of shareholdings carrying out material investments in different locations including Spain. LuxCo does not have employees and its 100 percent share capital is held directly by a non-EU resident Canadian pension fund.

Pursuant to the Directive, LuxCo requested from the Spanish Tax Authorities a full refund of the dividend withholding tax applied in Spain by the Spanish company in its dividend payments.
The Spanish tax administration denied the full refund to LuxCo, contending that the Directive's anti-avoidance provisions should apply.
According to the Spanish tax administration, the exemption could not be applied as 100 percent LuxCo share capital is held directly by a non-EU company; and LuxCo failed to prove it was incorporated for valid economic reasons.

"The fact that LuxCo is controlled by a non-EU resident Canadian pension fund is not enough to say the structure is abusive"

The Spanish National High Court followed the ECJ dividends, Eqiom and Enka, Deister Holding and Danish conduit cases, confirming that the Spanish tax authorities and not the taxpayer, should bear the burden of proof when determining whether the main purpose of the entity receiving dividends is to benefit from the Parent-Subsidiary exemption.
In view of the Spanish National High Court, the Spanish tax authorities had failed to prove that the LuxCo was not incorporated for valid economic reasons and the presumption that the incorporation of LuxCo was purely tax driven for the sheer fact that the parent LuxCo is a Canadian pension fund infringes the holdings of the referred ECJ case law.
In addition, the Spanish National High Court confirmed that EU holding companies can benefit from the Parent-Subsidiary exemption if they can show that, according to a set of objective and subjective elements, there is no abusive or fraudulent use of the provisions.
On the other hand, the Spanish National High Court understand that the fact that the LuxCo is controlled by a non-EU resident Canadian pension fund is not enough to regard the LuxCo as an instrumental vehicle.

To do: check investments in Spanish companies in view of criteria mentioned in court decision

The Spanish National High Court decision deserves a positive appreciation, to the extent that represents a change in approach in the burden of proof of abuse in the framework of the implemented Parent-Subsidiary Directive.
The Spanish National High Court now concluded that it is for the Spanish tax authorities to prove that all the elements of an abusive practice are present, and it prevented the tax authorities from transferring the burden of proof onto the taxpayer to demonstrate that an exception to the anti-abuse rule applies.
In our opinion, when advising non-resident taxpayers investing in Spanish entities through these types of corporate structures, the criteria stated by the Spanish National High Court through this new ruling must be taken into consideration.