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The Spanish Supreme Court confirms that a Canadian resident pension fund, and other non-Spanish pension funds, may be exempt from Spanish tax on Spanish source dividends (and any other Spanish source income)

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## In particular, the Spanish Supreme Court confirms that a Canadian resident pension fund may be exempt from Spanish tax on Spanish source dividends

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On 22 December 2020, and in line with specific recent rulings concerning undertakings for collective investments, the Spanish Supreme Court handed down an important ruling turning down the difference in tax treatment between Spanish and non-Spanish resident pension funds, which have been so far subject to Spanish withholding tax on dividends paid by Spanish resident companies.

A 22 December 2020 ruling from the Spanish Supreme Court (the “**Ruling**”) has confirmed that **taxing non-Spanish resident pension funds** on dividends paid by Spanish resident companies **may be contrary to the European Union (“EU”) free movement of capital principle**.

By way of reference, **Spanish-resident funds are Corporate Income Tax taxpayers subject to Spanish income tax on their worldwide income at a 0% rate**.

On the contrary, non-Spanish resident funds are subject to a **19% Spanish source dividend withholding tax**. However, an **exemption at source may apply to pension funds (i) established within the EU or the European Economic Area (“EEA”)** (if there is an exchange-of-information clause between the EEA country and Spain); and (ii) **equivalent to Spanish pension funds**. In addition, most tax treaties ratified by Spain provide for, at least, a **tax treaty reduced 15% dividend withholding tax**. In addition, the current Protocol to the **Canadian-Spanish Tax Treaty** (which had not entered into force at the time the tax was assessed on the Canadian Pension Fund), introduced an **exemption on dividends** paid by Spanish resident companies to Canadian pension funds provided that certain requirements are met.

The **Supreme Court Ruling** established that a tax on Spanish source dividends earned by a Canadian pension fund was contrary to EU law if the non-EU pension fund could evidence that **“it is in the same situation as pension funds resident in Spain and that it complies with the same requirements and participates of the same nature as the latter”**. In other words, if the non-Spanish pension fund is **“objectively comparable”** to a Spanish pension fund, such non-Spanish pension fund

should be exempt from Spanish non-resident income tax on any Spanish-sourced income (including dividends, interest or capital gains).

Although its conclusions are in line with previous considerations applicable to non-EU undertakings for collective investment, the **Supreme Court Ruling is extremely significant because of its scope and far reaching consequences**, which exceeds the taxation of dividends earned by Canadian pension funds. The following conclusions must be made:

- (i) **The exemption will apply to any EU and non-EU pension fund** which can evidence that *“it is in the same situation as pension funds resident in Spain and that it complies with the same requirements and participates of the same nature as the latter”*. This conclusion does not entail that the situation of the non-EU pension fund is “identical” to that applicable to a Spanish pension fund but that it is “objectively comparable”.
- (ii) The exemption would not be applicable to investments carried out by Special Purpose Vehicles set up by the non-Spanish pension fund.
- (iii) The Ruling assimilates for income tax purposes Spanish resident and non-Spanish resident pension funds, which means that **all Spanish-sourced income earned by assimilated non-Spanish pension funds must be taxed at a rate of 0% and, therefore, exempt from Spanish tax**.
- (iv) The Ruling is based on the existence of an infringement of the EU free movement of capital principal. As a consequence, **the conclusion of the Ruling does not apply to a non-Spanish pension fund investment when the EU principle of freedom of establishment applies**. This would be the case when, on the basis of the factual pattern of the investment made by the pension fund in the Spanish company, one can conclude that the pension fund can exert **“a definite influence”** on the Spanish company’s decisions, as this concept has been defined by the EU Court of Justice, and which must be analysed in depth.
- (v) **Non-Spanish pension funds** which have been subject to withholding tax on e.g. Spanish source dividends and interest, **are entitled to request a refund of the Spanish withholding tax** to the Spanish Tax Administration, at least for taxes paid within the four years statute of limitations period.

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