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Spain's Central Tax Tribunal adopts the CJEU's doctrine in the 'Danish cases'

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Spain's Central Tax Tribunal adopts the CJEU's doctrine in the 'Danish cases' in respect of the domestic exemption for interest payments to European Union entities provided for in Art. 14(1)(c) of the Non-Resident Income Tax (Recast) Act.

Spain's Central Tax Tribunal (TEAC[1]), in its Decision of 8 October 2019 (185/2017), applies the 'Danish cases' doctrine - contained in the Judgment of the Court (Grand Chamber) of 26 February 2019 in joined cases C-115/16, C-118/16, C-119/16 and C-299/16 - to a case in which a Spanish company paid financial interest to its Dutch parent company, the latter being controlled by an entity domiciled in Curacao which, in turn, was controlled by an Andorran company whose sole shareholder is an individual also resident in Andorra.

1. TEAC Decision

In the above context, the complainant understood, by virtue of the exemption provided for in Art. 14.1c of the Non-Resident Income Tax (Recast) Act, that it was not under an obligation to make withholdings on account of the aforementioned tax on the income paid on the loans granted to it, an interpretation which the government did not share, considering that the Dutch entity was a shell company which was not considered to be the beneficial owner of such income,

[1] Tribunal Económico-Administrativo Central.

a capacity which could be attached to the Andorran company, the actual holder of the loans and, therefore, of the income paid by the Spanish company. For this reason, the Administration considered that it was appropriate to make withholdings on account of the aforementioned tax by applying a withholding of 21% on the aforementioned interest, which led to the adjustment whose relevance is here the subject of analysis by the Central Court.

As can be seen from the above, the Inspectorate based its adjustment on the concept of 'beneficial owner' in Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. The complainant disputes the Inspectorate's view and, although it does not question that the capacity of 'beneficial owner' certainly applies to the Andorran company, its contention is focused on the fact that this concept is inapplicable to the exemption provided for in the aforementioned Article 14(1)(c), since it does not envisage this anti-abuse provision with regard to interest, as opposed to what happens with other types of income declared to be exempt, such as dividends or royalties. Therefore - adds the complainant - in the absence of a specific anti-abuse provision, the Inspectorate should have resorted to one of the general anti-abuse provisions contained in our legal system, such as those provided for in Articles 15 and 16 of the Tax Act. The taxpayer argues that this is the view held by the *Audiencia Nacional* in its Judgment of 31 October 2017, as well as by the Central Tax Tribunal itself in a decision dated 8 October 2015[2].

For the purposes of resolving the question, the Central Tax Tribunal refers to the judgment of the Court of Justice of the European Union in so far as it makes a pronouncement, as far as is relevant here, on questions relating to the concept of 'beneficial owner' and the existence of a legal basis for refusing exemption in the event of an alleged abuse of rights. In that sense, and taking into consideration the said doctrine, the Central Tax Tribunal pivots its arguments on a series of points, among which the following should be highlighted:

— The beneficial owner clause provided for in the said directive is a material requirement for the application of the disputed exemption.

— The interpretation of the exemption has to be made in accordance with the purpose and objectives of the directive, the national concept of 'beneficial owner' or its absence being irrelevant. Therefore, the non-existence of the aforementioned clause in the internal legislation does not prevent its application by the Administration.

— The category of beneficial owner involves the actual enjoyment of the income and, therefore, the possession of real powers regarding decision-making and its control, use and enjoyment.

[2] Although not cited by the taxpayer because it is subsequent, we can also find a similar view in a decision of the Catalan Tax Tribunal dated 4 October 2018.

— The EU's general principle of prohibition of abusive practices must be interpreted more broadly and applied autonomously, without being subject to the requirement of transposition.

— Accordingly, the authorities of a Member State are under an obligation to interpret and apply national law in the light of the wording and purpose of EU directives in order to achieve the result pursued by those directives.

Applying the above to the case at hand, the Central Tax Tribunal - after recalling that there was no disagreement between the parties in acknowledging that the Dutch entity is not really the beneficial owner of the interest paid and that it is merely a shell company whose bank accounts do not reflect the existence of any business activity - considers that the Inspectorate acted correctly in refusing to exempt the interest in question, which leads it to consider that both the withholding and the adjustment made by the Administration are appropriate.

It thus recalls the need for the authorities of the Member State in question - in this case, Spain - and the national courts reviewing the act to interpret national law in accordance with the objectives and purpose of the directive, a vague distinction making no sense if the rule comes from the domestic legal sphere and not from the transposition of the directive: Firstly, because whether or not there is a transposition the general principle would apply; secondly, because whether or not there is a domestic rule or conventional standard, the general principle would apply; and, finally, because Act 62/2003 had already examined the aforementioned Spanish legislation in order to bring it into line with the directive.

In short, the Central Tax Tribunal concludes that "defending a different conclusion would be tantamount to improperly circumventing EU legislation and to evading the explicit intention that the European court of last resort shows in this matter.

However, with regard to the penalty also appealed against in this case, the Central Tax Tribunal does uphold the complainant's claims, on the understanding that the personal element of guilt cannot be determined in this case, since such has been resolved in the light of the CJEU's doctrine as set out in judgments which did not exist at the time when the facts occurred, and it is therefore considered appropriate to quash the contested decision imposing the penalty.

2. Final considerations

As can be seen, the impact of this decision of the Central Tribunal is very relevant, since it concludes that the CJEU's doctrine in the Danish cases is automatically applicable to the exemption of interest paid to non-residents of the EU provided for in Spanish domestic legislation. If this interpretation is confirmed by our courts, it will have practical implications for the review of current structures, as well as for the cost of refinancing Spanish companies with non-resident entities (since lenders, as a general rule, require grossing up in the event of withholding taxes on interest payments applying).

However, it should be noted that the Central Tax Tribunal's decision does not mention that the exemption currently provided for in Spanish national legislation for interest paid to non-residents of the European Union is not a transposition of the directive. In this regard, the current exemption was introduced in 1990 (thirteen years before the entry into force of the directive) and with much less requirements: no requirement that the recipient of the interest should have a specific legal form or minimum taxation, no requirement for a minimum shareholding between creditor and debtor and, most importantly, no requirement that the recipient of the interest should be the beneficial owner of the interest. It is therefore questionable whether the 'Danish cases' doctrine applies directly to the Spanish national exemption, as this is an exemption that is not a direct transposition of the directive. According to a literal interpretation, this would mean that the rest of the requirements - in addition to the beneficial owner clause - provided for in the directive and not included in the Spanish national legislation should also be necessary to be able to apply the exemption. It is clear that this interpretation should not succeed.

Therefore, in respect of this Central Tax Tribunal decision, the position the Spanish courts, and in particular the *Audiencia Nacional*, take will be essential. In our opinion, this decision should not be endorsed by the Courts bearing in mind the *Audiencia Nacional* (31 October 2018) itself has already reached a determination on this issue in which it clearly concludes that, in the absence of a specific anti-abuse provision, the Tax Inspectorate is fully entitled to question the structures that it considers to be conflicting in the application of tax legislation (abuse of law), while observing the formal procedure, but in no case can it directly demand the application of the beneficial owner clause provided for in the directive.

If you have any questions, please contact one of the following lawyers:

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