Euro Tax Flash from KPMG's EU Tax Centre

[Background](#)

[The AG's Opinion](#)

[EU Tax Centre comment](#)

Advocate General's Opinion on Denmark's withholding tax on dividends paid to foreign investment funds

Dividend Withholding Tax – Free movement of capital – Comparability – Investment Funds – UCITS - Investors – Distribution requirement

On December 20, 2017, Advocate General (AG) Mengozzi of the Court of Justice of the European Union (CJEU) published his Opinion in the Fidelity Funds case (C-480/16), concerning the compatibility with EU law of the Danish withholding tax on dividends distributed to non-resident investment funds. The AG concluded that the Danish legislation constitutes an infringement of the free movement of capital.

Background

The case concerns Fidelity Funds and NN (L) SICAV, two investment funds having their registered offices in the United Kingdom and in Luxembourg respectively. Both UCITS claimed the repayment of the withholding tax levied on dividends received from Danish companies between 2000 and 2009, based on EU law.

Under Danish legislation, dividends distributed by a resident company to a foreign UCITS were taxed at a rate of 25% in 2000, rising to 28% between 2001 and 2009. However, dividends paid to a Danish UCITS were exempt from withholding tax, if the latter benefited from Article 16C fund status, by making a minimum distribution to its investors or, as from June 1, 2005, technically calculated such a minimum distribution.

The taxpayers argued that this different treatment was contrary to the free movement of capital and requested a refund of the tax levied. They also argued that the minimum distribution requirement is contrary to the freedom to provide services.

The AG's Opinion

Following settled case law from the CJEU in this respect, the AG first noted that the free movement of capital is applicable to the case at hand, taking into account the purpose of the legislation concerned. He then observed that UCITS resident in Denmark with an Article 16C fund status were exempt from tax, whereas non-resident UCITS were automatically excluded from the exemption. As this difference in treatment may discourage non-resident UCITS from investing in Danish companies and investors resident in Denmark from acquiring shares in foreign UCITS, the AG concluded that the Danish tax legislation constitutes a restriction to the free movement of capital.

In light of the existence of such a restriction, the AG further noted that the comparability of the situations at issue must be examined, especially having regard to the aim pursued by the national provisions at issue, i.e. preventing double taxation and ensuring that dividends distributed by Danish companies are taxed in Denmark at the level of the UCITS investors. With respect to the objective to prevent double taxation, the AG first held that resident and non-resident UCITS are in a comparable situation, since Denmark chose to tax dividend income received, not only by resident but also by non-resident shareholders. Regarding the objective to preserve Denmark's power to tax, the AG questioned the ability to assess comparability at the level of the investors. Referring to the two criteria set by the Danish legislation to benefit from the tax exemption, the AG took the view that the residence criteria takes precedence over the minimum distribution requirement and therefore comparability should be assessed at the level of the UCITS. Nevertheless, he further observed that the situation of the investors could also be taken into account, since the Danish legislation establishes a link between the grant of the tax exemption and the tax situation of the UCITS investors. Specifically, the AG identified three situations where the comparability of the tax situation of UCITS investors can be analysed: (i) resident investors investing in resident or non-resident UCITS, (ii) resident investors of resident UCITS compared with non-resident investors of non-resident UCITS, and (iii) non-resident investors investing in resident or non-resident UCITS. The AG concluded that in all three scenarios, investors are in an objectively comparable situation.

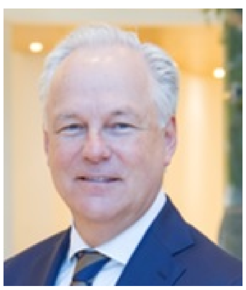
As a consequence, the AG went on to assess whether the restriction can be justified by an overriding reason in the public interest. He first rejected the justification relating to the balanced allocation of power to tax between Member States, and elaborated further on the need to safeguard the coherence of the tax system. In the AG's opinion, since the Danish rules make the tax exemption conditional on an (actual or technical) minimum distribution to investors, which is subject to Danish withholding tax, the advantage granted to resident UCITS in the form of a withholding tax exemption is offset by the subsequent taxation of the dividends distributed onwards, in the hands of their investors. Therefore, the restriction may be justified. However, the AG further concluded that such a restriction is not proportionate, as a less restrictive measure would be to allow non-resident UCITS to benefit from the withholding tax exemption, provided they pay a tax equivalent to that which Danish funds are liable to levy on the minimum distribution required.

EU Tax Centre comment

The AG's Opinion provides some interesting insight into whether the comparability analysis should be carried out at the level of the investment fund or whether the situation of the investors should also be considered, especially in cases where a withholding tax exemption on dividends distributions is subject to a minimum distribution requirement. The AG also shed some light on the validity of the need to safeguard the coherence of the tax system as a justification in this respect. However, it remains to be seen whether the CJEU will incorporate the AG's Opinion into its final decision.

Worthy of note are the AG's final remarks that non-resident UCITS receiving dividends from Danish companies may voluntarily satisfy the distribution conditions in their own resident state in order to comply with the Danish legislation and receive an exemption from tax at source, so long as the non-resident UCITS pay a tax that is equivalent to the tax that Danish Article 16C funds are required to retain on the minimum distribution. The AG seems to suggest relinquishing source state taxing rights to the UCITS Member State when the (participants of the) UCITS pay a tax that is equivalent to the Article 16C withholding tax. The consequences of this could be that UCITS based in countries without a dividend withholding tax would continue to suffer withholding tax in the source state. However, UCITS based in countries with a dividend withholding tax would be able to avoid economic taxation. Participants who are able to claim a full tax credit are then better off if they invest through UCITS based in countries with a dividend withholding tax. In such cases, there would be no level playing field and a new distortion of the internal market has been created. With that in mind and the fact that the source state has to give up its taxing rights, it remains to be seen whether this Opinion will be followed by the CJEU.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.



Robert van der Jagt
Chairman, KPMG's EU Tax Centre and Partner,
Meijburg & Co

KPMG's EU Tax Centre, Laan van Langerhuize 9, 1186 DS Amstelveen, Netherlands