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CJEU decision in the Fidelity Funds case regarding 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 – Coherence of the Tax System - Proportionality

On June 21, 2018, the Court of Justice of the European Union (CJEU) rendered its decision 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 Court concluded that the Danish legislation is contrary to 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, and having portfolio investments in Denmark that did not exceed 10% of the share capital of the participations held. 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 paid 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. In addition, UCITS benefiting from the Article 16C fund status have the obligation to withhold tax chargeable to their investors from such a minimum distribution.

The taxpayers argued that this different treatment is 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 CJEU decision

Following settled case law, the CJEU first noted that the free movement of capital is applicable to the case at hand, taking into account the purpose of the legislation concerned. The Court 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 tax treatment of dividends, according to in particular the UCITS' place of residence, may discourage non-resident UCITS from investing in Danish companies and investors resident in Denmark from acquiring shares in foreign UCITS, the Court concluded that the Danish tax legislation constitutes a restriction to the free movement of capital.

Turning to the question whether this difference in treatment relates to situations that are objectively comparable, the Court first recalled that this should be assessed based on an overall assessment having regard to the aim, purpose and content of the Danish legislation. The aim of the Danish legislation is to prevent economic double taxation at the level of both the UCITS and their investors, while ensuring that the dividends distributed by Danish companies are at least taxed once (i.e. at the level of the investors). With respect to the objective of preventing double economic taxation, the Court noted that because Denmark chose to levy tax on the income received by non-resident UCITS, the latter are in a situation comparable to that of UCITS resident in Denmark. As regards the objective to ensure that taxation effectively takes place at the level of the investment fund's investor, the Court first recalled that only the relevant distinguishing criteria in the Danish legislation must be taken into account to assess whether situations are in fact comparable. In the case at hand, the Danish legislation introduces – in addition to the UCITS Danish residence - a second criterion, namely a minimum distribution requirement and the corresponding obligation for the investment fund to act as withholding agent on behalf of its investors. However, the Court took the view that this second criteria is not decisive, as it merely corresponds to a method used to tax investors. In this respect, Denmark may only tax Danish resident unitholders, whether investing in Danish or in foreign UCITS. As a consequence, resident and non-resident UCITS are in an objectively comparable situation.

The Court then went on to assess whether the restriction can be justified by the need to ensure a balanced allocation of taxing rights and by the need to safeguard the coherence of the tax system. The Court first rejected the balanced allocation of power to tax between Member States as a justification, and elaborated further on the need to safeguard the coherence of the tax system. 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.

Nevertheless, 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 benefiting from the Article 16 C fund status are liable to levy on the minimum distribution required. Consequently, the Court concluded that the Danish legislation is contrary to the free movement of capital.

EU Tax Centre comment

The case 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 dividend distributions is subject to a minimum distribution requirement. In Aberdeen (C-303-07), Santander (C-338/11) and Emerging Markets (C-480/16) the only relevant distinguishing criteria in the domestic legislation was the place of residence of the UCITS, meaning that the tax situation of the investors were irrelevant for the purpose of determining whether or not that legislation was discriminatory. In the case at hand, the Court took the view that a minimum distribution requirement and the corresponding obligation for the investment fund to act as withholding agent on behalf of its investors is not decisive either to distinguish between resident and non-resident UCITS. It will be interesting to see whether and to what extent the existence of a third criteria concerning a shareholder's identity in the Dutch Köln-Aktienfonds case (C-156/17) may impact the CJEU's views on this.

Case	Country	Criteria		
		Residence	Distribution	Shareholder
Aberdeen C-303/07	Finland	✓	✗	✗
Santander C-338/11	France	✓	✗	✗
Emerging Markets C-448/16	Poland	✓	✗	✗
Fidelity Funds C-480/16	Denmark	✓	✓	✗
Köln-Aktienfonds C-156/17	Netherlands	✓	✓	✓

Nevertheless, it remains to be seen to which extent non-resident investment funds that do not satisfy the minimum distribution requirement will, on the basis of this decision, be able to successfully reclaim the withholding taxes paid in Denmark. Going forward, it is also worth noting the Court's conclusion, in line with the Advocate General's remarks, that a less restrictive measure may be to allow non-resident UCITS receiving dividends from Danish companies to 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, as 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 implementation of similar measures by Denmark would be likely to raise numerous issues at the level of the investors, including the availability of tax credits in the investor's state of residence.

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

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