CJEU decision in the A-Fonds case

Dividend Withholding Tax – Free Movement of Capital – Existing Aid - Netherlands

On May 2, 2019, the Court of Justice of the European Union (CJEU) rendered its decision in the A-Fonds case (C-598/17) concerning state aid as it relates to a Dutch dividend withholding tax refund claim. The CJEU ruled that the referring court is not competent to assess whether the residence requirement in the Dutch dividend withholding tax regime is compatible with the free movement of capital, insofar as granting a refund of the tax levied on a public entity would constitute state aid.

Background

From 2002 to 2008, A-Fonds, a German investment fund with no legal personality received Dutch-sourced dividends, which were subject to 15% withholding tax in the Netherlands. According to the referring court, the German investment fund should be considered to be transparent for Dutch tax purposes. For that reason the fund should not be regarded as the beneficial owner of the dividend, but the investor in the fund. Under Dutch law, public entities are exempt from corporate income tax and are therefore entitled to a full refund of Dutch withholding tax levied on dividends received from Dutch equities. A-Fonds' single investor, a German bank established in the form of a savings bank ("Sparkasse") took the view that it should be classified as a public entity under Dutch law. On this basis, it requested a refund of the withholding tax paid.

That request was denied on the grounds that A-Fonds was not established in the Netherlands. A-Fonds appealed this decision, arguing that such a requirement is contrary to EU law. The Gerechtshof 's-Hertogenbosch (one of the Dutch regional Courts of Appeal) concluded that the refusal to grant a refund constituted an infringement of the free movement of capital and that a refund should be granted to A-Fonds. However, the court also questioned whether such a decision is compliant with EU State aid law, because Dutch banks are always subject to corporate income tax, and therefore, would not be able to claim a refund of dividend

withholding tax. As such, allowing this refund to a German bank may constitute selective – and therefore illegal – state aid.

A-Fonds argued that the Dutch law on public entities already existed when the Netherlands joined the EU in 1958 (EEC at that time) and as such, if the refund did qualify as aid, it should be deemed "existing aid" and therefore be grandfathered. However, the Dutch tax authorities took the view that the possibility of reclaiming withholding tax on dividends did not exist yet in 1958 and therefore the refund qualifies as "new aid", subject to a legal review by the European Commission. In October 2017, the Dutch court referred the case to the CJEU, asking whether a refund would constitute "existing aid" or not. And if the refund is to be regarded as new aid, the Dutch court further requested clarification on whether it has jurisdiction to grant a refund to A-Fonds and how to notify such new aid to the European Commission.

The CJEU decision

The Court first examined whether the questions referred were admissible and concluded that giving a response to the referring court will indeed be useful for the resolution of the dispute before it, assuming a tax refund would constitute a system of aid in the case at hand.

The CJEU then analyzed whether the Dutch court had jurisdiction to assess whether the residence requirement in the Dutch dividend withholding tax regime is compatible with the free movement of capital, or whether such an assessment must exclusively be carried out by the European Commission, as it relates to a system of aid that may constitute illegal state aid. In this respect, the Court noted that the assessment of the compatibility of aid measures with the EU market falls within the exclusive competence of the European Commission, irrespective of whether EU freedoms may also be infringed. However, national courts may independently evaluate certain features of an aid measure in light of the fundamental freedoms, to the extent that those features are not necessary to achieve the objectives or the proper functioning of the aid.

In the present case, the Court concluded that the requirement of residence in the Netherlands for a public entity to benefit from a refund of Dutch dividend withholding tax is indistinctly linked to the very object of the measures at issue. As a consequence, the Dutch court may not assess whether such residence requirement complies with the free movement of capital, where granting a dividend tax refund to a public entity would constitute state aid. Consequently, the Dutch court may not grant a refund to A-Fonds, based on an infringement of the free movement of capital. The Court therefore deemed it unnecessary to answer the question whether such refund would constitute an existing or a new aid.

EU Tax Centre comment

The decision of the CJEU is broadly in line with the conclusions of its Advocate General. The residence requirement has been removed from Dutch law since January 1, 2007, so that residents of an EU member state can also apply for a refund of Dutch withholding tax. It could therefore be argued that Dutch law is no longer contrary to EU law as of that date. For that reason the Dutch court does not have to test whether there is an infringement with the free movement of capital.

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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