Euro Tax Flash from KPMG's EU Tax Centre

Background

CJEU Decision

EU Tax Centre comment

CJEU decision regarding Netherlands' withholding tax on dividends paid to foreign investment funds

Netherlands – Withholding Tax on Dividends – Investment Fund – Free Movement of Capital – Fidelity Funds

On January 30, 2020, the Court of Justice of the European Union (CJEU) rendered its opinion in the *Köln-Aktienfonds Deka* case (C-156/17) concerning the compatibility with EU law of the Dutch withholding tax on dividends distributed to non-resident investment funds. The Court found that the distribution requirements imposed by Dutch legislation in order to benefit from a tax refund were contrary to the free movement of capital.

Background

Köln-Aktienfonds Deka (KA Deka) is a contractual investment fund established in Germany, which is compliant with the requirements of the EU Directive 2009/65/EC on Undertakings for Collective Investment in Transferable Securities (UCITS). KA Deka had portfolio investments in the Netherlands that did not exceed 10% of the share capital of the participations held. The UCITS claimed the repayment of the withholding tax levied on dividends received from Dutch companies between 2002 and 2008, based on equal treatment under EU law.

Under Dutch tax law, dividend distributions to both resident and non-resident investment funds are subject to a 15% withholding tax. However, Dutch funds that elect to be treated as a "Fiscal Investment Institution" ("FII") are in the years in question entitled to a refund of the dividend withholding tax they have paid provided that they meet profit distribution and certain shareholders requirements. On the contrary, the Dutch withholding tax on dividend distributions constitutes a final tax burden for foreign investment funds, as they are not entitled to any tax refund upon distribution of their profits. KA Deka argued that this different treatment is contrary to the free movement of capital and requested a refund of the tax levied.

On March 27, 2017, the Dutch Supreme Court decided to refer to the CJEU the question of whether the Dutch withholding tax treatment is in line with the free movement of capital. As a

result of the subsequent CJEU ruling in the Fidelity Funds case (C-480/16), the questions were further amended in December 2018 to focus on whether the shareholders and distribution requirements are in line with EU law.

On September 5, 2019, Advocate General (AG) Pitruzzella concluded that the shareholder and distribution requirements imposed by the Dutch legislation in order to benefit from a tax refund may be contrary to the free movement of capital. Details of the AG's opinion were previously reported in Euro Tax Flash Issue 410.

The CJEU Decision

Fiscal Investment Institution shareholder requirements

Addressing firstly the shareholder requirements imposed by the Dutch legislation for qualifying FIIs, the CJEU held that both Dutch resident and non-resident investment funds are subject to the same conditions. In addition, the Court stated that non-resident taxpayers requesting the benefit of a tax advantage should not be subject to an excessive administrative burden, such that it is in fact impossible for them to qualify for the benefit. However, the fact that the non-resident fund in this case had difficulty providing supporting evidence that it fulfilled the applicable requirements was not a problem for which the Netherlands should have to answer. As such, the CJEU found that a requirement for proof to be provided to demonstrate that the shareholding requirements were satisfied did not, in and of itself, constitute a violation of the principle of free movement of capital.

However, the CJEU concluded that it was for the referring court (i.e. the Dutch Supreme Court) to determine whether discrimination exists regarding the manner in which the shareholder requirements of Dutch law are administered in practice for resident and non-resident investment funds. In this regard, where the Dutch tax authorities only request that information on shareholders is provided by non-resident funds and not by Dutch FIIs, this practice could be contrary to EU law.

Distribution requirements

In relation to the obligation, under Dutch law, for qualifying investment funds to distribute their profits within eight months of the end of the corresponding financial year, the CJEU found that the denial of the benefit of the FII regime to a non-resident fund whose profits are subject to tax in its state of residence, irrespective of whether such profits have been distributed or not, could constitute a restriction on the free movement of capital. This is particularly the case if it is impossible or excessively difficult for this non-resident fund to comply with the Dutch distribution requirement.

The CJEU discussed whether resident and non-resident investment funds are comparable in light of the objective of the Dutch regime to ensure tax neutrality between direct and indirect investments in Dutch securities. When making this assessment, the Court concluded that the Dutch tax authorities should take into account the tax paid to the German tax authorities when assessing whether the investment fund is entitled to a refund of the Dutch withholding tax. The Court also held that a requirement for the fund to actually distribute profits may not be relevant if the objective of the tax measure was achieved through other means. Finally, the CJEU noted that the Dutch Government did not provide any possible justifications for the restriction.

In light of the above, the CJEU concluded that this aspect of the Dutch legislation would be contrary to the free movement of capital in cases where it is impossible or excessively difficult for a non-resident fund to comply with the requirement, and the fund's profits are subject to tax in its state of residence, irrespective of whether the profits had actually been distributed to the non-resident fund's investors.

EU Tax Centre comment

The decision of the CJEU provides much needed clarity on a number of issues that the CJEU had left unanswered in its decision in the Fidelity Funds case (June 21, 2018, C-480/16). In particular, when assessing whether a non-resident fund is in an objectively comparable position to a resident fund, the main objective of the underlying legislative measure should be considered. When making this assessment, the Court held that a tax imposed in the state of residency of the fund could be considered against a tax imposed in the source jurisdiction from which the dividend payment was made. The fact that the requirement for distributions to actually be made may no longer be relevant could also be significant for non-distributing accumulation funds, where investors are taxable on the basis of a deemed yield rather than distributions received.

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

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

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