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Dutch Supreme Court decision on Dutch withholding tax on dividends paid to foreign investment funds (Köln Aktienfonds Deka)

Dividend withholding tax – EU law – EU freedoms – Comparability – Foreign investment funds – Double taxation

On October 23, 2020 the Dutch Supreme Court issued its ruling following the CJEU's decision in the Köln Aktienfonds Deka case (C-156/17) concerning the compatibility with EU law of Dutch withholding tax on dividends distributed to non-resident investment funds.

The Supreme Court ruled that its earlier judgments from 2013 and 2015 were an incorrect interpretation of EU law and that foreign investment funds should be entitled to a refund of the Dutch dividend withholding tax paid if certain conditions are met. These conditions are however very difficult to meet. Furthermore, it seems that foreign funds – unlike Dutch funds – are not provided with a mechanism to avoid economic double taxation. This raises the question whether this decision is contrary to case law of the Court of Justice of the European Union (CJEU).

Background

Köln-Aktienfonds Deka (KA Deka) is a contractual investment fund established in Germany, which complies with the requirements of EU Directive 2009/65/EC on Undertakings for Collective Investment in Transferable Securities (UCITS). KA Deka claimed the refund 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 (25% until 2007), but Dutch funds that elect to be treated as a fiscal investment institution ('FII') are entitled to a refund of the dividend withholding tax they paid in the years in question, provided that they meet profit distribution and certain shareholder requirements. However, 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 withheld.

On March 27, 2017 the Dutch Supreme Court decided to refer to the CJEU the question whether the Dutch requirements for the FII regime are in line with the free movement of capital. As a result of the CJEU ruling in June 2018 in the Fidelity Funds case (C-480/16), the questions were further amended in December 2018 to focus on whether the shareholder and distribution requirements are in line with EU law.

The CJEU decision of January 30, 2020

Although the Dutch shareholder requirements do not discriminate, as these rules apply equally to residents and non-residents, the CJEU concluded that it was for the Dutch referring court to determine whether discrimination exists regarding the manner in which these rules are administered in practice for resident and non-resident investment funds (see Euro Tax Flash Issue 422 for further details).

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 denying 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. The CJEU 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, such as in Germany where the profits of the fund are included in the income of the investors even if the profits are not distributed.

Dutch Supreme Court decision of October 23, 2020

Although the Dutch Supreme Court acknowledged it had ruled incorrectly in 2013 and 2015, this decision (reference ECLI: NL:HR:2020:1674) is disappointing and may again be contrary to EU law.

With regard to the profit distribution requirement, the Court held that income inclusion rules as they were applied in Germany are satisfactory. However, the profits to be taxed at the level of the investor should be calculated based on Dutch, and not German, rules. This may have the adverse consequence that the German fund can never qualify if the recalculated profits under Dutch law are higher than the profit under German law.

With regard to the shareholder requirements, the CJEU was very clear in paragraph 62 of its judgment, in that the national court must investigate whether rules are administered without distinction. Like German funds, Dutch UCITS do not know who their shareholders are. Nevertheless, the Dutch Supreme Court ruled that foreign investment funds must meet the shareholder requirements. The Supreme Court did however acknowledge the point made by the CJEU in paragraph 62. The reason why the Supreme Court did not address this difference in treatment by the Dutch tax authorities is very likely that the Supreme Court restricted its judgment to answering the questions that were referred by the Court of Appeals in Breda (and this issue was not included in the questions referred by this Court).

Another question to be addressed was what was meant with “any tax” in paragraph 84 of the CJEU’s Fidelity Funds ruling of June 2018 (C-480/16). Is this tax paid in the source country or does it relate to the country where the fund is resident? According to the Dutch Supreme Court, this is without a doubt the source country, thus the Netherlands in the KA Deka case. It also held that the foreign fund can apply for a refund of the Dutch dividend withholding tax paid, if it makes a ‘replacing payment’. The replacing payment is computed as follows (step 1):

(15% x worldwide profits) minus foreign withholding tax paid.

A foreign investment fund will be eligible for a refund of the Dutch dividend withholding tax paid if and to the extent that the Dutch dividend withholding tax paid exceeds the amount of the replacing payment (step 2).

The rules introduced by the Dutch Supreme Court raise many questions, such as:

- Are UK dividends or Dutch interest income received (which are both exempt from withholding tax in those countries) within the scope of the 15% replacing payment? That seems to be the case and would result in the strange conclusion that the Netherlands imposes a “tax” on UK dividends and Dutch interest income.

- Will other countries such as Germany accept the replacing payment as a creditable withholding tax? If not, double taxation arises, which means that the objective of the Dutch FII regime is not met (avoiding economic double taxation). The question arises whether this is compatible with EU law.

EU Tax Centre comment

Many foreign investment funds were looking forward to the Dutch Supreme Court decision. Although the Supreme Court acknowledged that it had applied EU law incorrectly in its judgments in 2013 and 2015 (concerning a Finnish and a Luxembourg investment fund), this ruling does not provide the clarity everyone had hoped for, because many elements of the decision are either unclear or possibly contrary to EU law.

A first observation from Meijburg & Co, a KPMG firm in the Netherlands, is that the Supreme Court’s line of reasoning is that the foreign fund should be given the same treatment as funds that are based in the Netherlands. For that reason, the replacing payment reflects the same amount that a Dutch fund would have paid as dividend withholding tax. The Court then applies the case law of the CJEU in the Miljoen and X cases (C-10/14, C-14/14, September 17, 2015), which gave the Court cause to reconsider its earlier judgment that year. That line of reasoning is reflected in step 2 (discussed above) as this step requires that the tax burden of a non-resident may not be higher than the tax burden of a resident. It should be noted that in previous CJEU case law this burden comparison was limited to source country income (which is not the case in the method developed by the Dutch Supreme Court which includes worldwide income).

Secondly, it is important to look at the objective of the Dutch FII regime, which is to prevent economic double taxation when investments are made indirectly (through an investment fund). An essential element of achieving this objective is that the underlying dividend withholding tax is passed on upwards to the investors. In other words, the (Dutch and foreign) dividend withholding tax paid by the fund is refunded to the fund and replaced by dividend withholding tax withheld by the fund from its participants. In this way, together with the 0% corporate income tax rate, economic double taxation is avoided. Under EU law, the system introduced by the Supreme Court – in terms of avoiding economic double taxation – should not be to the detriment of foreign funds. It is unclear how economic taxation is avoided in the solution of the Supreme Court.

For that reason, the European Commission could potentially intervene as it did in Denmark in November 2019 after the 2018 CJEU ruling in the Fidelity Funds case (. The European Commission can initiate infringement proceedings before the CJEU if it believes that a Member State is applying domestic rules in a manner incompatible with EU law. Since the European Commission has already opened a file concerning the same issue for Denmark, it would not be surprising if it did this for the Netherlands as well.

The next step in the KA Deka case is that the Court of Appeals – that referred questions to the Supreme Court, which now have been answered – will resume the court proceedings based on the input received from the Supreme Court (and 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.

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