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CJEU decides in Dutch net taxation case

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Key Summary:

On November 7, 2024, the Court of Justice of the European Union (CJEU or the Court) rendered its decision in case C-782/22. The case concerns a UK-based life insurance company that received dividend income from passive investment shares in the Netherlands and suffered 15% Dutch dividend withholding tax on the gross dividend income.

In summary, the Court found that Dutch legislation that allows resident entities to deduct from the tax base expenses directly linked to the investment income, whereas no such option is available to non-resident entities, constitutes an unjustified restriction of the EU free movement of capital, in so far as there is a direct link between the dividends received on the one hand and the increase in the obligations to unit linked policy holders on the other hand.

The plaintiff was represented by KPMG.

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CJEU – The Netherlands – Withholding tax on dividends – Net taxation – Free movement of capital

Case XX C-782/22 concerns a UK-based life insurance company that received dividend income from passive investments in the Netherlands and suffered Dutch withholding tax on the gross dividend income. The Dutch dividends were received as part of unit linked products that were offered to UK pension schemes. These dividends were subject to 15 percent Dutch dividend withholding tax, which was a final tax for non-residents.

For Dutch taxpayers, the withholding tax represents a pre-payment of corporate income tax that can be fully offset against the corporate income tax due. Where the corporate income tax due is lower than the dividend tax already levied, the taxpayer receives a refund of the difference. For Dutch entities that operate a comparable business model as the plaintiff in the case at hand, the effective tax burden on such dividends is zero. This is due to an offset against the dividend income of an equal amount representing the corresponding increase of the provision for obligations to the policy holders, which reduces the tax base for Dutch corporate income tax purposes to zero. For Dutch taxpayers, the dividend withholding tax is as a result effectively fully refunded.

The CJEU held that the different treatment in the Netherlands of resident and non-resident companies constitutes an unjustified restriction of the EU free movement of capital if there is a direct link between the dividends received on the one hand and the increase in the obligations to unit linked policy holders on the other hand. The question whether such direct link exists must be answered by the national court. Different from what the Dutch tax authorities argued, the 2015 CJEU judgment C-17/14 does not apply in the presence of such a direct link. That judgment only allowed a deduction of the costs connected to the collection of the dividend income.

Background

Background

On December 14, 2022 the Dutch of Court of Appeal (ECLI:NL:GHSHE:2022:4471) referred preliminary questions to the CJEU concerning the interpretation of, in particular, the CJEU's judgment in case C-17/14 of September 17, 2015 (ECLI:EU:C:2015:608) and whether this applies in general to all cases where a non-resident receives dividend income from another member state (which is the view of the Dutch tax authorities).

Case C-17/14 dealt with the so-called "net taxation" issue, which, in essence, deals with the difference in treatment between resident taxpayers subject to tax on a net basis (i.e., income less expenses), and non-resident taxpayers that are subject to withholding tax on a gross basis (i.e., the income is taxed in full, with no possibility to deduct related expenses). Based on settled EU case law, a non-resident should not be treated less favorably (i.e., subject to a higher level of taxation) than a resident taxpayer in a comparable situation, unless the difference in treatment is justified by an overriding reason in the public interest. The result of applying this general principle to a "net taxation" case is that, in calculating the tax base, a non-resident is entitled to claim a deduction from its gross revenues of directly related expenses.

Case C-17/14 dealt with a very specific "net taxation" situation, whereby a French bank received dividend income from the Netherlands which was subject to a 15 percent Dutch dividend withholding tax. In its judgment, the CJEU ruled that – in order to level the playing field with comparable resident entities – the French bank was only entitled to a deduction of the costs that related to the collection of the dividends but not to other directly related expenses.

The Dutch tax authorities interpreted the CJEU's judgment in the C-17/14 case as meaning that the UK-based life insurance company was not entitled to a deduction of amounts representing the increases of the provision for obligations to the policy holders corresponding to the dividend income received.

The UK life insurance company challenged this assessment and argued in front of the Dutch Court that the facts in C-17/14 are fundamentally different compared to the case at hand and that for that reason the CJEU's judgment in that case is not relevant here. The fundamental difference between the two fact patterns is that – in the case of the UK insurance company offering unit-linked products, the dividend income was critical to its business model and it service offering to its clients, whereas that seems to have been different in case C-17/14 case. Given this difference, the CJEU's judgment in that case should not be the principal basis for resolving the dispute in the case at hand, which should rather be decided upon in light of previous CJEU judgements on "net taxation" that refer to the deductibility of expenses directly related to the income derived from the Netherlands.

CJEU decision

The CJEU ruled that the costs incurred as a result of an increase in the company's future payment obligations – which results in a deduction when calculating taxable income for a comparable resident unit linked insurance company – should be taken into account when determining the taxable base of a non-resident unit linked insurance company. In other words, a non-resident company should have the same effective tax burden on the Dutch source dividends as a company that is a resident of the Netherlands.

The CJEU referred to its previous case law in noting that resident and non-residents are in a comparable situation as regards costs, such as business expenses directly linked to an activity which has generated taxable income, and that a direct link exists where costs are incurred due to that activity, which are therefore necessary for carrying out that activity. Although the CJEU recalled its decision in case C-17/14 (among others) in noting that in the case of dividend specifically such a link exists only if those costs are directly linked to the collection as such of the dividends. It further noted that it cannot be held on the basis of that decision alone that the situations of residents and non-residents receiving dividends are not comparable in the light of the Dutch legislation at issue.

The CJEU referred instead to its judgment of November 13, 2019, in case C-641/17 (EU:C:2019:960) and emphasizes that this judgement is ruled after the date of case C-17/14 of September 17, 2015. The CJEU held, in essence, in case C-641/17 that a non-resident pension fund that uses dividends received to contribute to the provisions of the pensions it will have to pay in the future, is in a comparable situation to a resident pension fund which increases future liabilities based on the same mechanics. Furthermore, the CJEU pointed out in that decision that the receipt of dividends led to a proportional increase in the technical provisions and therefore that there was a direct link between the receipt of dividends and the corresponding increase in those technical reserves. It is important to note in this context, that all pension funds are in principle required by law to invest insurance premiums received on the capital market in order to generate income in the form of dividends enabling them to meet their future obligations under insurance contracts. In that respect, resident and non-resident pension funds are comparable, according to the CJEU.

CJEU decision

In the case of the UK unit linked insurance company, the Dutch referring court observed that, although the company is not a pension fund, its activity nevertheless consists of investing sums of money, including in Dutch shares, to cover its obligations towards its clients under unit-linked contracts, and that the investment results lead to a corresponding change in the financial obligation towards its clients (and therefore in an increase in the related technical reserves).

The referring Dutch court also considers that there is a direct causal link between investment results and changes in the company's liabilities and that, precisely as a result of that link, a Dutch tax resident company does not pay Dutch corporate income tax on those dividends (since there is an economic link between those dividends and changes in the amount of its liabilities to clients).

The CJEU concluded that, if it appears that under Dutch domestic law such a direct link exists between the dividends received by resident companies and the change in their obligations towards clients, a non-resident company is objectively comparable to a resident company. It is up to the national court to ascertain these facts and to determine whether under (Dutch) domestic tax law the objective is to effectively exempt these dividends from corporate income tax (see CJEU November 8, 2012, C-342/10, EU:C:2012: 688, paragraph 42). If the referring court considers that a non-resident company is in a situation objectively comparable to that of a resident company, and that the disputed Dutch legislation represents a restriction of the EU free movement of capital, it must be further examined whether the difference in treatment may be justified by overriding reasons in the public interest. The CJEU assessed whether the restriction may be justified by the need for a balanced allocation of taxing rights and the need to preserve the coherence of the tax system and dismissed their validity as possible justifications.

ETC Comment:

The CJEU's decision is a welcome clarification of the narrow application of its previous decision in case C-17/14. On the contrary, the CJEU equated the fact pattern in the case at hand with that dealt with in case C-641/17 and therefore acknowledged that the dividend income received by the plaintiff in relation to its unit-linked business is critical to the business model of the plaintiff and its service offering to its clients. The referring Dutch court observed that, although the company is not a pension fund, its business model and the resulting implications with respect to its the financial obligation towards its clients are equivalent. Furthermore, the referring court also noted a direct causal link between investment results and changes in the company's liabilities. It may be inferred from these assessments that, light of the CJEU's decision, it is likely that the referring court will confirm the unjustified difference in treatment.

This judgment is not only relevant for insurance companies with unit linked service offerings, but potentially also for other non-resident (life) insurance companies and pension funds deriving dividend income from another member state. This is not necessarily restricted to EU resident investors only.

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