

# UCITS funds

may claim back withholding taxes on investment returns



As a result of the developments in the European Court of Justice and a recent EFTA Court case, PwC has analysed to what extent investment funds that have UCITS status and that are organised as corporate funds face tax discrimination when conducting business across Europe. We have found that the imposition of withholding taxes on dividends to such UCITS funds in many EU countries could amount a breach of the free movement of capital in Article 56 of the EC Treaty. This view is supported by leading European Legal Counsel.

# The Issue

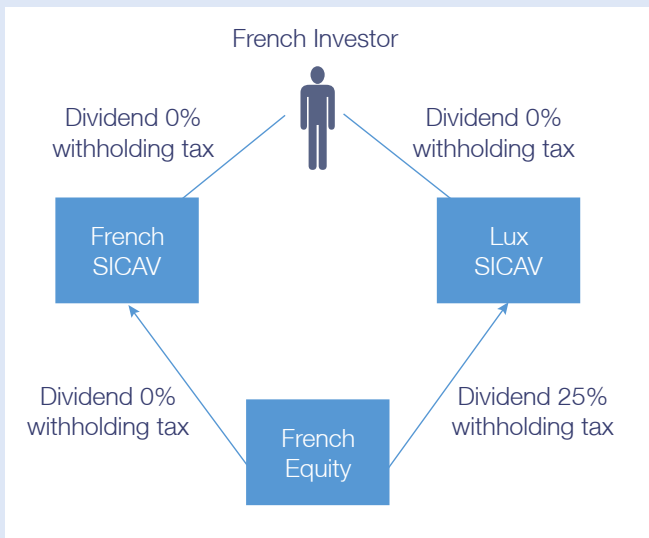
In most Member States of the European Union (EU), domestic investment funds can benefit from a (partial) exemption or refund of withholding taxes levied on dividends received from a domestic entity. This is different in the case of foreign investment funds making similar investments in that Member State. The exemption or refund regulations usually do not apply to withholding taxes levied on dividends received from companies in other EU Member States.

Foreign funds are therefore at a disadvantage as their net income will be lower than the net income of comparable local investment funds.

This is a breach of the free movement of capital in Article 56 of the EC Treaty.

## Example 1: French distribution to either French or Luxembourg Fund

In this example a French investor has a choice of investing via either a French SICAV (a mutual UCITS fund) or a Luxembourg SICAV (again a UCITS fund).



The French resident SICAV is exempt from withholding tax whereas a similar dividend to a Luxembourg SICAV will be subject to the non treaty rate of withholding tax of 25%.

It is clear that the investor in the Luxembourg SICAV would be worse off than if he had invested in a French SICAV since he is taxed in full on the net distribution from the Luxembourg SICAV and receives no credit for the withholding tax suffered by the fund.

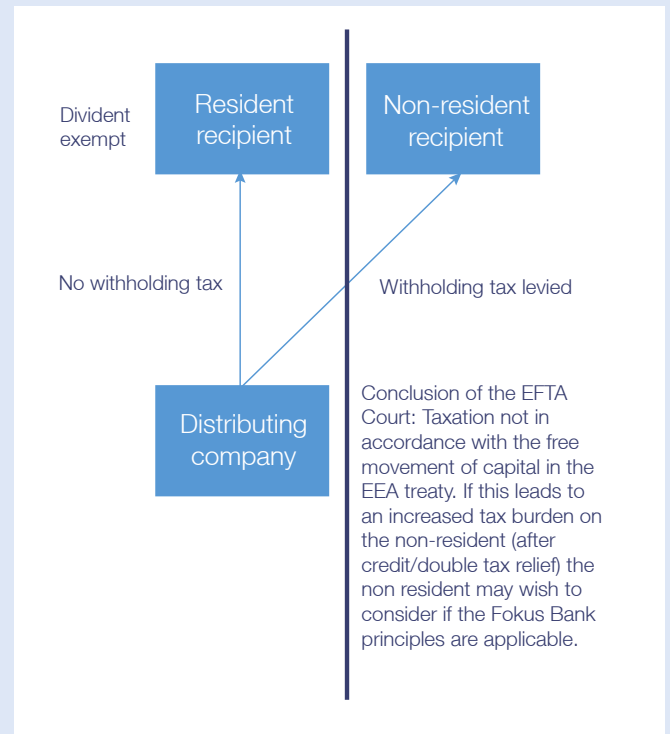
## Example 2: Fokus Bank Case: dividends taxable only for non-residents

A similar case has already been decided by the EFTA Court in respect of normal corporations – Fokus Bank case (E-1/04, 23 November 2004), and another one is pending with the ECJ, also in respect of normal corporations - Denkvit case (C-170/05).

### Fokus Bank Case

In this case the court found that the Norwegian domestic tax system avoided double taxation on dividends. This was because no withholding tax was levied on domestic dividends and Norwegian shareholders were not subject to further tax when they received the dividend.

The court found that such systems have as their policy aim the avoidance of chargeable taxation on dividends.



Consequently in the single market established by the EU, such benefits should also be available to non resident shareholders investing cross border. In this case the shareholders suffering withholding tax on Norwegian dividends were from Germany and the UK. The failure to extend these benefits to non-resident shareholders amounted to a restriction of the free movement of capital, and therefore, was in breach of the EFTA Treaty.

# What should corporate UCITS funds do next?

It is clear that, following the Fokus Bank Case, UCITS funds can make claims for recovery of withholding taxes suffered in certain EU countries, even where the rate suffered is equivalent to the treaty rate. Indeed a failure to make appropriate claims could, if material, be subject to challenge by shareholders in the funds who would be worse off as a result of investing cross border.

As a first step fund boards or the fund manager should assess the amount of withholding taxes suffered over the last 3 to 5 years on EU cross border dividends to ascertain the magnitude of the potential claim.



## How to claim a refund?

*Some practical questions and answers*

### What time limits apply to refunds?

To claim back withholding taxes levied within the EU (ie Member States and in countries that are part of the European Economic Area) investment funds should file a request for a refund as soon as possible. The refund request must be filed within the applicable local time limits for refunds. The applicable periods differ per country, ranging from 3 months to 5 years after payment of the dividend.

### What information needs to be included?

This may vary from country to country. Generally speaking, the fund would be required to indicate in the claim:

- the amount of dividends received
- the amount of tax withheld
- the details of underlying shares/bonds and the paying company
- the date of payment of the dividends
- the amount of withholding tax already recovered (if any)

This means that the refund claim should be accompanied by the dividend vouchers (generally provided by the custodian), bank statements and copies of refund claims already filed.

### What if the local tax authorities deny the refund?

The local authorities may query the basis for the refund claim filed. In that case it may be necessary to provide a formal opinion to the local authorities to support the claim being made. It may also be necessary to lodge an objection or appeal where that claim has been denied or commence judicial proceedings.

It is probably advisable to simultaneously lodge the details of the claim with the European Commission. This is because the Commission is obliged to pursue a claim made with the appropriate legal argument on the claimant's behalf, and the Commission is the sole body able to take the matter directly to the European Court for adjudication.

## More information

If you are interested in our experience with these cases or wish to receive additional information, please discuss this with your local PwC contact, who will be able to tell you about the case and its implications.

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