

Newsalert

EU Direct Tax Group

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OPINION OF ADVOCATE GENERAL IN CASE 40 037 BEFORE THE SUPREME COURT OF THE NETHERLANDS: DIFFERENT TAXATION OF DOMESTIC AND FOREIGN DIVIDENDS RECEIVED BY DUTCH INVESTMENT FUNDS IS IN BREACH OF THE FREE MOVEMENT OF CAPITAL ENSHRINED IN ARTICLE 56 OF THE EC TREATY

Dutch investment funds benefit from a special tax regime (0% corporation tax on net investment income, if distributed to shareholders no later than 9 months after the financial year concerned) and are entitled to a refund of tax withheld on dividends from foreign investments in countries with which the Netherlands has concluded a double tax treaty which provides for a tax credit. The refund is reduced in proportion to the number of shares owned by non-residents in the investment fund claiming the refund. However, investment funds are entitled to a refund of tax withheld on domestic dividends irrespective of the place of residence of its shareholders.

On May 3, 2005, Advocate General *Wattel* delivered his opinion in Case 40 037, which is currently pending before the *Hoge Raad* (Supreme Court of the Netherlands). The case concerns a Dutch investment fund that was denied a refund of tax withheld on dividends from Portuguese and German investments (in the years concerned, no double tax treaty was in force between the Netherlands and Portugal, and the double tax treaty between the Netherlands and Germany did not provide for a tax credit in respect of dividends paid by a German resident company to a Dutch resident shareholder). In addition, the investment fund was also denied a refund of tax withheld on dividends received from investments in qualifying treaty countries in so far as its shareholders were resident outside of the Netherlands.

Following the recent decisions of the ECJ in *Manninen*, *Lenz* and *Weidert & Paulus*, the Advocate General first considers that, as a general rule, the free movement of capital of Article 56 of the EC Treaty requires that EU dividends receive no less advantageous tax treatment than domestic dividends and, therefore, a Dutch investment fund is, in principle, entitled to a refund of tax withheld on EU dividends irrespective of the terms of the double tax treaty with the Member State concerned, if any, and the place of residence of its shareholders, as these are not relevant for a refund of tax withheld on domestic dividends either. According to the Advocate General, the decision of the ECJ in the *Gilly* case, however, implies that the fundamental freedoms cannot be interpreted such as to require a Member State to refund tax levied by another Member State, which would entail a loss of tax revenue for the first Member State and would thus be such as to seriously encroach on its sovereignty in matters of direct taxation. Essentially adopting a look-through approach, the Advocate General concludes that the refund of foreign tax withheld on EU dividends is limited by the amount of Dutch (withholding) tax due by the shareholders if and when such dividends are distributed by the Dutch investment fund as required by law. As regards the refund of foreign tax withheld on dividends received from third countries, the Advocate General doubts whether the free movement of capital between Member States and third countries as guaranteed by Article 56 of the EC Treaty requires that the above principles must equally be applied to such dividends, and therefore advises the *Hoge Raad* to stay proceedings and refer the matter to the ECJ for a preliminary ruling.

For more detailed information, please do not hesitate to contact your local PwC contact person or a member of the EUDTG.

Frank Engelen +31 10 407 53 02

frank.engelen@nl.pwc.com

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