

Newsalert

EU Direct Tax Group

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Judgement of the Dutch *Gerechtshof* of 's-Hertogenbosch: Dutch dividend withholding tax is in breach of EC law (Case 03/01980).

X Sarl, incorporated under the laws of Luxembourg and a resident for tax purposes of Luxembourg, owns 2.25% of the shares in A N.V., incorporated under the laws of the Netherlands and a resident for tax purposes of the Netherlands. A N.V. distributed dividends to X Sarl in 2001 and 2003, which were subject to 25% Dutch dividend withholding tax. Pursuant to the Netherlands-Luxembourg tax treaty the rate of 25% was reduced to 15%, and therefore X Sarl was entitled to a refund of 10%. Based on Community Law, X Sarl applied for an exemption from Dutch dividend withholding tax with respect to the dividends received from A N.V.

The Dutch Dividend Withholding Tax Act (*Wet op de dividendbelasting 1965*) provides for two exemptions in parent-subsidiary relations. The first exemption applies to dividends distributed by Dutch subsidiaries to Dutch parent companies, to which, for Dutch corporate income tax purposes, the participation exemption applies. The second exemption applies to cross-border dividends which are covered by the Parent-Subsidiary Directive. Since the interest in A N.V. held by X Sarl was less than 25%, the dividend did not qualify for an exemption from withholding tax pursuant to the Directive. Since X Sarl was a resident of Luxembourg, the internal exemption from dividend withholding tax applied neither.

The *Gerechtshof* of 's-Hertogenbosch is of the opinion that the internal exemption is not in line with article 56(1) EC, as it effectively differentiates between resident and non-resident shareholders. It is contrary to EC law that X Sarl is subject to 15% withholding tax in the Netherlands whereas a Dutch resident shareholder receiving the same dividend would not be subject to any withholding tax or corporate income tax in the Netherlands at all. It should be noted that the Dutch participation exemption should have applied to the interest in A N.V. held by X Sarl, if it would have been a resident for tax purposes of the Netherlands. Subsequently, the *Gerechtshof* addressed the issue whether, under these circumstances, a resident shareholder and a non-resident shareholder are comparable. Referring to *Asscher*, the Court stated that it is of no relevance that X Sarl is not subject to Dutch corporate income tax. The only relevant criterion is that X Sarl is, in principle, subject to corporate income tax in a EU Member State. Therefore, the situation of a resident shareholder and a non-resident shareholder is, in principle, comparable. In addition, this position is confirmed by the circumstance that the dividends distributed by A N.V. to X Sarl are also exempt from corporate income tax in Luxembourg. According to the *Gerechtshof*, the tax withheld in the Netherlands on dividends distributed to non-resident shareholders constitutes a restriction of the free movement of capital. In this particular case, the restriction cannot be justified by the principle of territoriality or the coherence of the Dutch tax system.

This decision of *Gerechtshof* of 's-Hertogenbosch is of great practical importance. It effectively means that dividend distributions to non-resident companies that are not covered by the Parent-Subsidiary Directive because the minimum shareholding threshold of that Directive is not met should not be subject to Dutch dividend withholding tax on the basis of EC law, if a comparable resident shareholder is entitled to the participation exemption. The reasoning of the *Gerechtshof* is equally valid for dividend distributions to foreign pension funds, which are not eligible for a refund of Dutch dividend withholding tax in circumstances where a domestic, tax-exempt pension fund would be.

Please note that if the Dutch tax authorities decide to appeal to this decision, the Dutch *Hoge Raad* may decide to refer this case to the ECJ for a preliminary ruling, or await the decision of the ECJ in the pending *Denkavit* case.

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