

The Aberdeen case (ECJ/C-303/07/June 18, 2009)

Discriminatory EU withholding tax on dividends ruled illegal by European Court

Investment funds can claim millions back in overpaid dividend withholding tax from governments across Europe, following a European Court of Justice (ECJ) ruling that a Finnish tax withheld on dividends paid to foreign investment funds is considered illegal.

The ruling in the case of Aberdeen Property Fininvest Alpha Oy is one of the first cases in the European Courts to consider the legality of an EU member state levying dividend withholding taxes only on dividends paid to non-resident investment funds while exempting domestic investment funds from such taxes.

On June 18, 2009, the ECJ issued its judgment in the Aberdeen Property Fininvest Alpha Oy case. The decision is of considerable significance for the European investment management industry as it is the first time the ECJ has considered the compatibility with the EC Treaty of an EU Member State levying withholding taxes only on dividends paid to non-resident investment funds while exempting domestic investment funds from such taxes. The Court finally took a decisive position on some of the most commonly used arguments to justify the differentiation in treatment between domestic and foreign funds. All of them were rejected!

Aberdeen is a Finnish resident real estate company wholly owned by a real estate fund structured as a Luxembourg SICAV. The case concerns Finnish rules which subjected dividends paid by Aberdeen to its Luxembourg SICAV parent to withholding tax.

PwC represented Aberdeen in both the Finnish courts and then the ECJ assisting them in challenging the compatibility with the EC Treaty of the levying of Finnish withholding tax on the dividends it paid. The case was referred to the ECJ to rule whether the imposition of withholding tax by Finland on dividends paid to a non-resident company constituted as a Luxembourg SICAV while exempting Finnish resident parent companies and investment funds from such taxes is contrary to Article 43 (freedom of establishment) and 56 (free movement of capital) of the EC Treaty.

Under Articles 43 and 48, as well as Articles 56 and 58 of the EC Treaty, persons that are objectively comparable to each other are entitled to equal tax treatment. Thus a company such as the Luxembourg SICAV must be considered 'comparable' to the local company and/or investment fund in order to sustain an argument that the differing withholding tax treatment is discriminatory.

The ECJ ruled in favour of Aberdeen dismissing every one of the Finnish government's arguments. The judgment both confirms the principles established in earlier cases on dividend withholding taxes, and applies them specifically in an investment fund context.

The ECJ stated that (1) Differences between the legal forms of the funds were not presented to be sufficient to create an objective distinction with respect to exemption from withholding tax on dividends received; (2) It does not matter that the recipient fund is not liable to domestic corporate taxes in its home territory; (3) It is not appropriate to consider the tax position at the level of the investors; (4) The imposition of a withholding tax could not be justified by the need to counteract the risk of tax avoidance.

In particular the judgment clarifies a number of important issues that we have seen raised by numerous European tax authorities in response to our clients' withholding tax reclaim applications. The Court concluded:

- Investment funds of different legal form are comparable and so this argument cannot justify a difference in treatment
- It does not matter that the recipient fund is not liable to domestic corporate taxes in its home territory
- It is not appropriate to consider the tax position at the level of the investors
- The imposition of a withholding tax could not be justified by the need to counteract the risk of tax avoidance

This judgment is very welcome news for investment funds that have been subjected to discriminatory withholding taxes on dividends from EU/EEA member states and marks a significant step forward, confirming the validity of the arguments that PwC has put forward to Member State's tax authorities on behalf of its clients and, more importantly, rebutting each of the reasons tax authorities have presented thus far in rejecting claims.

Moreover, it reveals the strength of the position for those investment funds which have been perhaps reluctant to make withholding tax reclaims because, for example, they were outside the scope of the UCITS directive and so felt less comfortable with the arguments for comparability and therefore the case for making claims.

We recommend that all investment funds regardless of their legal structure, UCITS or non-UCITS, now review their past and future withholding tax position and considers the cost/benefit of making withholding tax reclaims.

Investment funds that have yet to file protective claims for the recovery of taxes should be aware that a statute of limitation will apply in each Member State to restrict the level of any payout, thereby increasing the need for prompt action.

How PricewaterhouseCoopers can help

In 2004, PwC identified the opportunity for investment funds, pension funds and life assurance companies to reclaim EU dividend withholding taxes. We formed the PwC Fokus Club, through which we have assisted our clients with filing protective tax reclaims in 13 European jurisdictions (including Finland) for the recovery of EU withholding taxes.

We have successfully assisted Fokus Club members in securing tax repayments from some EU Member States. Given the strength of today's judgment, we will continue to negotiate with Member States and other bodies to obtain further repayments for Fokus Club members (and non members!), and changes in future withholding tax legislation.

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