

# Reclaiming EU dividend withholding tax

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Interpretation of European law means non-EU entities can potentially obtain refunds of dividend withholding tax.



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The founding treaty of the European Union contains an express prohibition of national laws which restrict the free movement of capital between “Member States and Member States and third countries”. Over the past few years, this rule has been subject to numerous judgments of the European Court of Justice (ECJ), such that it now appears that the free movement of capital applies to investors based outside the EU making portfolio investments into Europe. This broader applicability of the free movement of capital creates opportunities for non-EU resident investors to file refund claims covering dividend withholding tax levied on their portfolio investments around Europe.

## Background

Article 56 of the EU treaty provides that: “all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.”

So far as taxation is concerned the ECJ has, over a number of years, handed down judgments that clearly state that:

- The payment of a dividend is a movement of capital;
- A withholding tax is a prohibited restriction where a resident recipient of the same dividend would not have suffered the same withholding.

That is to say, outbound dividends cannot be subject to higher taxation than domestic dividends. For example, it was held in the *Denkavit* case, that a 5% French withholding tax on a dividend paid to a Dutch recipient was unlawful because a comparable French recipient would not have been taxed, or not taxed at the same level, on the same dividend.

## Third country residents

The wording of Article 56 makes it clear that it applies to dividends paid by a company resident in the EU to a resident in a third country.

There are, however, certain caveats to the broader application of this rule, namely:

- The dividend must be paid in respect of a portfolio investment;
- There must be an exchange of information clause in the double tax treaty between the relevant paying and recipient states, enabling information to be obtained in respect of that investment.

## Recent developments

Portfolio investors have been filing protective reclaims with various EU Member States’ national tax authorities since 2004. Over the last few months, various countries have either started to make repayments or suffered defeats in their domestic courts.

Investors have received, or are due to receive, money from Norway, Austria, Poland, the Netherlands and France.

While there is, as yet, no ECJ judgment that deals expressly with third country residents, the case law which has developed to date in relation to third country issues, and other recent developments, lead us to believe that there is merit in third country residents submitting protective claims for the recovery of withholding taxes levied contrary to EU law.



## Who can claim?

The extension to third country residents potentially applies to all portfolio investors, such as:

- Investment funds;
- Pension funds;
- Charities or endowments;
- Insurance companies;
- Sovereign wealth funds.

Given the various developments that have taken place in the EU, therefore, portfolio investors investing in equities in EU Member States may wish to consider filing protective reclaims with the relevant taxation authorities, to reclaim withholding taxes suffered on dividends received from companies resident in those countries.

As a first step, potential claimants should undertake a cost-benefit analysis, bearing in mind not only the amounts of withholding tax at stake, but also that some analysis will be required on a country-by-country basis to determine the comparability of the claimant entity with the appropriate domestic entity and, consequently, the degree of discrimination.

## Adapting UK pricing models

Following a number of favourable European Court of Justice judgments in respect of the taxation of inbound dividends, UK authorised investment funds ('UK AIFs') have been advised to file their UK corporation tax returns on the 'protective' basis that EU source dividends should be exempt from tax. At the same time, given the uncertainty of this treatment, the liability to pay tax was still being recognised in the fund's accounts. In November 2008, the High Court in London handed down a judgement effectively confirming the position. Just as the court in London was dealing with the inbound tax issues, those UK funds that made 'Fokus Bank' claims in Norway and certain other jurisdictions have begun to receive repayments of withholding they suffered on dividends received. So, while the High Court judgment is subject to appeal, those responsible for UK authorised funds should continue to monitor their own situation in relation to receipt of Fokus Bank claims, as well as any amounts that may be receivable in respect of corporation tax paid on EU dividends should the appeal not be upheld. The need to consider the appropriate time to recognise these in the price of the fund and in the accounts. We note that it was confirmed in the 2009 Budget that from 1 July, 2009 non-UK dividends received by UK AIFs will generally be exempt from tax. UK AIFs will need to adapt their pricing models accordingly.

# Global Asset Management contacts

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